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The Chiang Mai Initiative

The leaders of the Association of Southeast Asian Nations, profoundly resentful at their treatment by the international community during the 1997-98 crisis,[1] reached out to the leaders of China, Japan, and South Korea in an effort to ameliorate their economic problems. The proposal of officials from Japan's Ministry of Finance for an Asian Monetary Fund had been scuttled in the face of opposition from within the region, the United States, the rest of the Group of Seven, and the International Monetary Fund. In November 1997, the ASEAN leaders invited the three leaders from Northeast Asia to their summit meeting in Kuala Lumpur. When they met for the second time as ASEAN+3 in Hanoi in 1998, China proposed that deputies from finance ministries and central banks meet on a regular basis to explore possibilities for cooperation. At their third meeting, in Manila in Fall 1999, the ASEAN+3 leaders issued a formal statement, their first, which identified ten areas for regional cooperation, including financial matters. The deputies and ministers then proceeded to develop a collective statement that would give concrete form to the political intention of the leaders.

1. Relevant treatments of the crisis include, among a number of others, Kenen (2001), Blustein (2001), Haggard (2000), Pempel (1999), Tadokoro (1999), Wang (1999), Kahler (1998), and Goldstein (1998).

Decisions at Chiang Mai

The Chiang Mai Initiative was announced by the ASEAN+3 finance ministers, convening in May 2000 on the margin of the annual meeting of the board of governors of the Asian Development Bank (ADB), as they usually do. The ministers announced their intention to cooperate in four principal areas: monitoring capital flows, regional surveillance, swap networks, and training personnel.[2]

First, because many officials in the region blamed volatile capital flows for the 1997-98 crisis, there had been a good deal of interest in monitoring such flows among countries in the region. Officials from ministries and central banks had discussed the desirability and feasibility of different monitoring schemes but had reached no final resolution. At Chiang Mai, they agreed that they would use the ASEAN+3 framework to "facilitate the exchange of consistent and timely data and information."

Second, the ministers agreed to establish a "network of contact persons to facilitate regional surveillance." Though expected to enhance the "effectiveness of [their] economic reviews and policy dialogues," this commitment was attached to the more far-reaching objective of "establishing a well-coordinated economic and financial monitoring system in East Asia."

Third, they reached an agreement with respect to financial cooperation; this is worth quoting directly:

> In order to strengthen our self-help and support mechanisms in East Asia through the ASEAN+3 framework, we recognized a need to establish a regional financing arrangement to supplement the existing international facilities. As a start, we agreed to strengthen the existing cooperative frameworks among our monetary authorities through the "Chiang Mai Initiative." The Initiative involves an expanded ASEAN Swap Arrangement that would include ASEAN countries, and a network of bilateral swap and repurchase agreement facilities among ASEAN countries, China, Japan and the Republic of Korea.

In a related action, the ministers asked the ASEAN secretariat to lead a study on "other appropriate mechanisms" that could bolster their ability to "provide sufficient and timely financial support to ensure financial stability in the East Asian region."

Fourth, the ministers agreed to establish a network of research and training institutions to strengthen the human capital of officials in the financial, banking, and fiscal areas throughout the region. Japan, China, and South Korea in particular offered technical assistance in these areas to ASEAN officials.

2. "The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting," May 6, 2000, Chiang Mai, Thailand. The quotations in the next several paragraphs are from this statement.

Four aspects of the ministers' joint statement are worth noting briefly. First, although the term "Chiang Mai Initiative" refers specifically to the swap arrangements (and is used here in that sense), the agenda laid down at Chiang Mai was considerably broader and included regional surveillance, capital-flow monitoring, and the training of personnel needed to enhance the value of these exercises.

Second, the CMI was an agreement to conduct further negotiations, rather than a final agreement on swap arrangements. The ministers suggested that they would use as their point of reference the swaps that had been in place among the ASEAN countries since 1977 when conducting subsequent negotiations and that in particular the new swaps would constitute a "network" in some sense. They and their deputies pursued these negotiations during the following year and announced their results in advance of the ADB annual meeting in Honolulu in early May 2001.

Third, whereas the US Department of the Treasury had been principally responsible for the rejection of the Asian Monetary Fund proposal in autumn 1997, Treasury took a softer though noncommittal line in the spring of 2000. The assistant secretary for international affairs, Edwin M. Truman, who represented Treasury at the ADB meeting, said that regional initiatives such as these could well be constructive in principle and that greater cooperation among Asian countries was "perfectly appropriate." But Truman reserved final judgment, cautioning, "The devil is in the details. If they are supportive of prompt financial and economic adjustment, then I think they are to be commended, but we don't know what will happen yet." An IMF representative welcomed the Initiative, noting that the Asians had stated their intention to work with the IMF.[3]

Fourth, the CMI captured the attention of financial analysts around the world because of the very high levels of international reserves held by the countries in the ASEAN+3 group. In early 2000, Japan and China held $305 billion and $157 billion in foreign exchange reserves, respectively (see figure 2.1), ranking behind only the combined total for Europe's monetary union. With ASEAN and South Korea, the total reserves of the "10 plus 3" countries were $729 billion, which did not include Hong Kong or Taiwan's foreign exchange reserves, nor ASEAN+3's noncurrency reserves, such as gold, Special Drawing Rights (SDRs), and reserve positions in the IMF.[4] By dedicating a moderate portion of total foreign exchange reserve holdings in the region to financial stabilization, say 10 to 20 percent, these countries could mobilize more resources than would be available to many of them from the multilateral financial institutions and Group of Ten countries.

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3. Arran Scott and James T. Areddy, "U.S., IMF Cautiously Welcome Asia Currency Swap Plan," Dow Jones International News, May 8, 2000.

4. IMF, *International Financial Statistics*; Roach (2000).

Follow-Through

After the meeting in Chiang Mai, the deputies and working-level officials from the central banks and finance ministries met on numerous occasions to discuss expanding the ASEAN Swap Arrangement (ASA) and introducing a set of bilateral swap agreements (BSAs). Officials added a set of existing repurchase agreements as a third item on the list of specific aspects of the CMI. Because they broke new ground and involved potentially large sums, the BSAs were the most important of these three elements. Officials' discussions of the bilateral swaps centered on, first, establishing a framework of principles and, second, negotiating individual bilateral arrangements.

The ASEAN Swap Arrangement

The swap arrangements of the Association of Southeast Asian Nations (ASEAN) date back to 1977.[5] These arrangements allowed members to exchange local currency for US dollars on a short-term basis to alleviate "temporary international liquidity problems." Participation was confined to central banks and monetary authorities of ASEAN member countries. Each member originally contributed $20 million, for a total of $100 million, which was increased to $200 million in 1978. Swaps could be for a period of 1, 2, or 3 months and were renewable once for up to 3 months.

The swaps were activated on five occasions—by Indonesia in 1979, Malaysia in 1980, Thailand in 1980, and the Philippines in 1981 and 1992—in small amounts.[6] Because this facility was small relative to the trade and capital flows of the countries in the region, needless to say, these arrangements made only a minor contribution to the resolution of payments difficulties. During the crisis of 1997-98, the ASA was not activated.

In November 2000, ASEAN leaders agreed at an informal summit meeting to expand their swaps under the CMI. The overall size of the ASA would be increased to $1 billion, and the arrangements would include the new as well as prior members of ASEAN, whose overall membership had grown to 10.[7] The prior members, described as "tier 1 countries,"[8] would contribute $150 million each; and the new members, "tier 2 countries,"

5. "Memorandum of Understanding on the ASEAN Swap Arrangements," Kuala Lumpur, August 5, 1977, found at http://www.asean.or.id/economic/muswap.htm.

6. Communication from the Bank of Thailand.

7. Also see "Joint Ministerial Statement, Meeting of ASEAN Finance Ministers," Prague, September 2000, paragraph 10.

8. Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand (Rana 2002, 9).

would contribute various amounts up to $60 million.[9] Both tiers would be eligible to borrow the maximum of twice their contribution, or $300 million in the case of tier 1 countries. Swaps can now be drawn for up to 6 months, with one extension for a period not exceeding 6 months.[10]

Although they serve as a symbol of ASEAN solidarity, these arrangements are limited in their likely contribution to future crises—particularly those characterized by regional contagion—by four features. First, the amounts involved remain small, despite the augmentation. Second, creditors can opt out of the arrangements. Although opting out was possible in “exceptional financial circumstances” at the inception of the ASA, the basis for doing so was made effectively unlimited in 1992.[11] Third, as has been true since the inception of the ASA, renewal of an outstanding swap is blocked if a second country applies for activation.[12] Fourth, though the rules governing the multiple activation of swaps are unclear, simultaneous activation by two or more borrowers is problematic.

Three additional points are nonetheless worth making. First, the presence of the ASA underscores the insistence by ASEAN that it be treated as a unit within regional cooperative arrangements, that it not be completely bypassed by direct dealing with its member states. Second, with the memoranda of understanding made public, the ASA has a moderate degree of transparency, greater than that of BSAs. Third, as a complement to the ASA, ASEAN has launched its own surveillance process, which could conceivably provide a foundation for more productive regional dialogues in the future.[13]

Bilateral Swap Agreements

In theory, the CMI provides for 33 bilateral currency swap agreements to be negotiated: 30 agreements between each of the 3 Northeast Asian countries and each of the 10 ASEAN members, plus 3 agreements among the 3 Northeast Asian countries themselves (see box 3.1). The number of BSAs that have actually been or are currently being negotiated is slightly less than half this number, however. Concessional foreign aid is regarded as a more appropriate form of assistance for the poorest members of

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9. Vietnam, $60 million; Myanmar, $20 million; Cambodia, $15 million; Laos, $5 million (Rana 2002, 9).

10. Park (2001a, 3).

11. “Fifth Supplementary Agreement to the Memorandum of Understanding on ASEAN Swap Arrangements,” Washington, September 19, 1992.

12. Article 4, paragraph 7, of the original memorandum.

13. ASEAN Finance Ministers, “Terms of Understanding on the Establishment of the ASEAN Surveillance Process,” Washington, October 4, 1998; found at http://www.asean.or.id/economic/term_fin.htm; Manzano (2001).

Box 3.1 What is a "currency swap"?

A currency swap is an agreement to exchange one currency for another and to reverse the transaction at a date in the future. These swaps are used widely in the private sector and are also used, though less often, among central banks. They involve two simultaneous transactions: (1) a spot transaction, exchanging currencies at the spot rate and (2) a forward transaction, reversing the exchange at a specified rate and time. The exchange rate for the reverse transaction can be the market spot rate, the market forward rate, or another rate specified in the agreement. Interest is usually paid on balances outstanding under swap arrangements. The duration for swaps is frequently 3 months, with an option to renew.

Central banks and finance ministries enter into agreements to make swaps available over a certain period of time. Under such standing agreements, swaps might or might not be activated. Alternatively, monetary authorities might swap currencies on an ad hoc basis in the absence of a standing agreement.

Basic features of swaps, and points of negotiation over agreements, include:

- Credit risk: Who bears the risk of failure to reverse the swap?
- Exchange risk: Who bears the gains or losses on exchange rate movements while a swap is activated?
- Activation: Must the creditor agree to exchange currencies under a standing agreement, or can the *demandeur* activate unilaterally?
- Size and terms: Up to what quantitative limit can currency be exchanged? For what duration? What interest would be paid on outstanding balances?
- Conditionality: Can the creditor require policy adjustments as a condition for activating the swap?
- Renewal: Can a swap, once activated, be rolled over at the expiration date and, if so, for how long?

Swaps are technically distinct from loans. They are exchanges of assets, which are recorded as foreign exchange reserves on the books of the recipients, and no collateral is pledged. But when a convertible currency is exchanged for a nonconvertible currency, the latter serves as minimal security for reversal of the swap, and the transaction may have the character of a loan.

The US Federal Reserve engaged in its first swap transaction in 1925, when Benjamin Strong provided $200 million in gold to the Bank of England against sterling to facilitate the reestablishment of the pound's pre-World War I gold parity. This transaction set the legal precedent for such arrangements by the Fed.

ASEAN, leaving the 4 large emerging-market countries—Thailand, Malaysia, the Philippines, and Indonesia—as the most serious candidates for BSAs. Although showing reluctance, Singapore has participated in at least one negotiation; South Korea, by contrast, has been quite active. Fourteen agreements have been announced or were expected as of mid-2002. New pairs of countries could in principle begin discussions on new agreements at any time within the framework.

Framework of Principles

The finance ministries of the ASEAN+3 agreed on a framework of principles for the BSAs in the autumn of 2000.[14] On the basis of this framework, finance ministries and central banks would negotiate bilaterally on specific swap agreements. Finance ministry officials were presented with ambitious plans for a genuine network of bilateral swaps.[15] Their bargaining focused on a narrower set of principles, however, covering the terms of financing, coordination across bilateral swaps, and the relationship to IMF financing and conditionality.

First, the framework's stated purpose is to provide "short-term" financial assistance in the form of swaps to member countries in need. Originally, this was described as being for "balance of payments support." Over the course of negotiations, however, some governments introduced a (somewhat vague) distinction between that and "short-term liquidity support," and both were included in the framework agreement.

Second, the swaps must supplement existing international financial facilities and specifically those of the IMF. As a condition for drawing most of the funds through the swaps, the borrower must have completed, or be nearing completion on, an agreement with the IMF. Such an agreement would condition financing on a package of policy reforms, sometimes strict, to be instituted by the borrower. By agreeing to tie their regional assistance to an IMF program, the ASEAN+3 ministers decided to effectively allow the IMF to determine the policy conditionality for most of the swaps. This provision is referred to as the "IMF link."

Given that the Asian Monetary Fund proposal ran afoul of concerns about undercutting the IMF during financial crises, it was no surprise that the IMF link was a critical issue during negotiations over the framework. Although the ministers agreed to the IMF link in the autumn of 2000, subsequent objections by Malaysian Prime Minister Mahathir Mohamad, a longstanding critic of the IMF, delayed full agreement on the principle until the spring of 2001. As a concession mainly to him, the ministers agreed that 10 percent of the swap could be activated without an agreement, or even a prospective agreement, with the IMF. Such a disbursement would represent "short-term liquidity support," would be renewable only once, and thus repayable within 6 months of the original transaction.

How the swaps might be related to the Contingent Credit Line (CCL) of the IMF is an interesting issue.[16] Potentially, an ASEAN country that

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14. The principles are not fully disclosed officially. Some important aspects of this framework can be found in "Progress of Bilateral Swap Agreement under the Chiang Mai Initiative," press release 30/2001, Ministry of Finance, Bangkok, May 1, 2001.

15. Park (2000); Yoshitomi and Shirai (2000).

16. The structure and function of the CCL is explained at http://www.imf.org/external/np/exr/facts/ccl.htm.

prequalified for IMF money under the CCL (although none have sought prequalification to date) might have secured swap money without having to submit to IMF conditionality. The ASEAN+3 ministers decided against CCL prequalification as a sufficient basis for disbursements under the BSA, however, requiring instead that the IMF actually activate the CCL before regional swaps can be executed.

Third, disbursements under the swap arrangement would be coordinated among the creditors. For example, if Thailand, which has BSAs in place with China, Japan, and South Korea, requested activation, it would draw on the three agreements simultaneously and equiproportionately, rather than exhausting one swap completely and then drawing on the others in sequence. If a creditor chooses to opt out, the remaining creditors might make up the difference in funds provided; but that decision would be made by the creditors on a case-by-case basis at the time of activation. The creditors would agree that one of them would serve as the coordinating country for joint activation of the swaps. It is in this relatively limited sense, as well as falling under the rubric of the principles framework, that the swaps constitute a network.

Fourth, the size of the swap facilities would be determined in each bilateral negotiation. Thus the bilateral agreements could provide for substantially different swap amounts. The currencies to be exchanged can also vary across bilateral agreements.

There are four points to note about the framework of principles. First, no central body or authority is in charge of overseeing or administering the arrangements. There is no pooling of foreign exchange reserves in a central location or account. The only actors in these arrangements are finance ministries and central banks. Second, there is no role for the regional group in the negotiation of the swap agreements or their activation or administration. Although a country would coordinate the creditors, they would be a small subgroup consisting of the three Northeast Asian participants. There is no ASEAN+3 decision to activate a swap or on its specific terms. Third, the creditor (meaning the country that is exchanging US dollars and receiving the partner's local currency) has discretion over the activation of the swap, and drawings are thus not automatically available. Fourth, though not one of the stated principles, the swaps would in practice exchange local currency for US dollars, with only one exception.

Bilateral Negotiations and Agreements

With the framework of principles in place, countries could proceed with their bilateral negotiations. Such negotiations fell into two groups: those between one of the Northeast Asian three, on the one hand, and one of the ASEAN members, on the other; and those between two of the Northeast Asian three. Japan began negotiating the specific features of the bilateral agreements in early 2001, announcing the initial results after an ASEAN+3 finance ministers' meeting in Honolulu in early May 2001,[17] and was followed by South Korea and then China. As of mid-2002, negotiations on 14 BSAs were either under way or had been concluded. Table 3.1 provides an overview of the results of these negotiations.

Japan has signed five agreements, with South Korea, Thailand, Malaysia, the Philippines, and China;[18] and it is expected to sign two additional agreements, with Singapore and Indonesia. Most of Japan's signed BSAs are in the amount of $3 billion, which the forthcoming agreements are expected to match. Korea has signed two agreements, with Japan and China, and is expected to sign three additional agreements, with Thailand, Malaysia, and the Philippines.[19] Those with Japan and China are in the amount of $2 billion while the forthcoming agreements are expected to be in the amount of $1 billion. China has signed two agreements, the one with Japan and one with Thailand,[20] and it is reportedly negotiating with two others, Malaysia and the Philippines.

These BSAs generally swap US dollars for local currency. The one exception is the Japan-China BSA, which would swap yen for renminbi.[21] Japan and China's swaps with ASEAN countries, and Japan's swap with Korea, are "one-way" arrangements, meaning that only one party has the right to draw dollars. Because Korea is both a potential borrower and creditor (owing to its high level of reserves), its BSAs with ASEAN members are "two-way" agreements, in which either party can draw dollars.[22] The Japan-China and China-Korea BSAs are similarly two-way

17. "The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting," May 9, 2001, Honolulu.

18. "The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting," May 9, 2001, Honolulu; Bank of Japan, press release, Tokyo, March 28, 2002.

19. Rana (2002); Amethyst Ma and Laural Pohl, "Manila Enters Talks about Swap Lines," *Asian Wall Street Journal*, March 26, 2002, M7; "Philippines and South Korea Plan Forex Swap Pact," Dow Jones International News, March 25, 2002; "Korea to Seal Currency Swaps with China, Malaysia in May," *Korea Herald*, February 23, 2002; "Government Seeks to Sign Currency Pacts with 4 Asian Nations by May," *Korea Times*, February 23, 2002; Andrew Marshall, "Thailand: Asian Economic Integration Lacks Key Factor—Unity," Reuters English News Service, April 2, 2002.

20. "Bilateral Swap Arrangement (BSA) between Thailand and the People's Republic of China," press release 73/2001, Ministry of Finance, Bangkok, October 30, 2001. Thai officials were asking Chinese authorities to increase the size of the BSA by half, to $3 billion. *Business Day* (Thailand), August 30 and 31, 2001; People's Bank of China, "The Central Banks of China and Thailand Signed Currency Swap Agreement," statement issued December 6, 2001, Beijing.

21. Announced by Japanese vice minister of finance Seiichiro Murakami at the ASEAN+3 finance ministers' press conference, May 9, 2001, Honolulu.

22. Korea's arrangements could also swap local currency for "another convertible currency."

Table 3.1 Bilateral swap agreements under the Chiang Mai Initiative

Countries	Status as of July 2002	Amount (billions of dollars)[a]	Currency
Japan- South Korea	Signed July 4, 2001	2	Dollar-won
Japan-Thailand	Signed July 30, 2001	3	Dollar-baht
Japan-Philippines	Signed August 27, 2001	3	Dollar-peso
Japan-Malaysia	Signed October 5, 2001	1	Dollar-ringgit
China-Thailand	Signed December 6, 2001	2	Dollar-baht
Japan-China	Signed March 28, 2002	3	Yen-renminbi
South Korea-China	Signed June 24, 2002	2	Dollar-renminbi or dollar-won
South Korea-Thailand	Announced, not signed	1	Dollar-baht or dollar-won
South Korea-Malaysia	Expected 2002	[1]	Dollar-ringgit or dollar-won
South Korea-Philippines	Expected 2002	1	Dollar-peso or dollar-won
Japan-Singapore	In progress	[3]	Dollar-Singapore dollar
China-Malaysia	In progress	[1]	Dollar-ringgit
China-Philippines	In progress	[1]	Dollar-peso
Japan-Indonesia	In progress	[3]	Dollar-rupiah

a. Brackets indicate provisional figures.

Sources: Compiled from multiple sources, including Kuroda and Kawai (2002), Rana (2002), Sakakibara (2001), and author's interviews.

agreements. Notably, the Japan-China swap is also exceptional in that it reportedly does not include the IMF link.

In these BSAs, the creditor retains the discretion to activate the swaps, which gives its finance ministry the ability to supplement conditions. Most of these agreements adhere to the 10 percent limit on disbursement in the absence of an agreement with the IMF. Up to that limit, funds can be drawn on a 90-day basis, renewable once. The remaining 90 percent of the swap facility also has a maturity of 90 days but can be renewed up to seven times, for a total duration of 2 years, presumably also at the creditor's discretion. The term of the swap could therefore extend beyond the short term to the medium term, roughly comparable to the term of credit available from the IMF's Supplemental Reserve Facility but shorter than normal IMF standby credit.[23] Interest on the initial

23. Drawings from the Supplemental Reserve Facility (SRF) are expected to be repaid in 1 to 1½ years and must be repaid within 2 to 2½ years. Drawings under standby arrangements are expected to be repaid within 2¼ to 4 years and must be repaid within 3¼ to 5 years. See, IMF, "Terms of IMF Financial Assistance," available at http://www.imf.org/external/np/tre/lend/terms.htm.

drawing and first renewal is paid at the London Interbank Offered Rate (LIBOR) plus 150 basis points. The rate on subsequent renewals rises 50 basis points every other renewal to a limit of 300 basis points over LIBOR.[24] These charges would be comparable to the IMF's charges on drawings under its CCL.

In the case of Japan, the Ministry of Finance holds most of the foreign exchange reserves and would thus be the supplier in any swap of US dollars for another's local currency. In such a transaction, however, the central bank would be the counterpart to the ministry. The ministry therefore insisted in its negotiations that the counterpart central banks have their governments guarantee the reversal of the swap. The guarantee reduces the risk born by the ministry and gives the swap the character of a dollar loan. The guarantee also brings finance ministries into the action as principal negotiators and parties to the agreements.

The facilities extended to South Korea and Malaysia would be in addition to, not replace, the facilities that Japan extends to the two countries under the New Miyazawa Initiative (NMI) of 1998. Those facilities amount to $5 billion in the case of Korea and $2.5 billion in the case of Malaysia. The NMI facilities are not available to support currency intervention, but are linked instead to short-term capital needs related to development and economic reform. Those facilities can nonetheless be drawn upon, irrespective of the borrower's standing with the IMF.[25]

It is important to note that the ASEAN ministers meeting in Honolulu agreed to review the principles of the CMI and the particular swap agreements in 3 years.

Repurchase Facilities

Between the Mexican peso crisis of 1994-95 and the Asian financial crisis, a number of East Asian countries concluded a series of agreements to discount US Treasury securities on an emergency basis.[26] The transactions would be reversed after a specified period of time. Because it has the region's largest economy, Japan's agreement of April 1996 with seven partners was perhaps the most significant of these "repurchase agreements."[27] Thailand drew on at least one of these arrangements in mid-1997 but was quickly overwhelmed.[28]

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24. Park (2001a, 4).

25. On the New Miyazawa Initiative, see Ministry of Finance, Japan (1998b).

26. Moreno (1997).

27. The seven partners were Australia, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. See Sheryl Wudunn, "U.S.-Backed Pact Puts Japan in New Role in Asian Finance," *New York Times*, April 27, 1996, 40, section 1.

28. *The Economist*, May 12, 2001, 73.

At Chiang Mai, it was thus natural for ministers and central bank governors to consider expanding these facilities as well. In addition to US Treasury notes or bills (with a remaining life of not more than five years), the securities of the counterparty government would also be eligible for repurchase.[29] However, because markets in US securities are open and highly liquid, there is arguably little to be gained from repurchase by regional partners. Moreover, East Asian governments and central banks hold relatively few securities issued by other governments in the region, and governments prefer not to repurchase their own issues. Therefore, no new repurchase facilities have been created since the Chiang Mai meeting, and ASEAN+3 governments have instead focused on developing the swap arrangements.

Financial Significance

These financial arrangements, the BSAs in particular, are quite significant. In comparison with the amounts of foreign exchange reserves held by countries in the region, the nominal size of the ASA and individual BSAs is modest. The largest of the bilateral swaps, $3 billion, is small compared with Thailand's IMF rescue package of 1997, for example, which was $17.2 billion, of which Thailand borrowed $14.3 billion. Thailand's external debt in early 2002 amounted to about $65 billion, of which about $12.5 billion was short-term debt.[30] However, these comparisons understate the importance of the CMI arrangements as a whole, for three reasons.

First, the potential borrowers have concluded multiple BSAs, which, when combined with funds available through the ASA, double or triple the total amount of funds available. The total size of the BSAs signed, announced, or soon expected as of this writing is $19 billion; completion of the negotiations in progress could raise this figure to $25-27 billion. In the cases of Malaysia and South Korea, moreover, the BSAs can be supplemented by facilities under the NMI, amounting to $7.5 billion. The grand total of CMI and NMI facilities could therefore reach the neighborhood of $35 billion.

Second, the BSAs are large in comparison with these countries' quotas in the IMF. (See tables 3.2 and 3.3.) Once their governments complete negotiations with China and South Korea, Malaysia may be able to borrow funds from the three Northeast Asian creditors and the ASA amounting to almost twice its IMF quota (excluding the NMI facility), and the Philippines

29. Rana (2002, 9).

30. Bank of Thailand, *Quarterly Bulletin* 42, no. 1 (March 2002): 28, available at http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/Publications/Bulletin/Q1-2002.pdf.

Table 3.2 Swap arrangements under the Chiang Mai Initiative, Northeast Asia to ASEAN (millions of US dollars)

	Bilateral swap agreements (BSAs)[a]							
	Creditor country							
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Borrowing country	**Japan**	**China**	**South Korea**	**Total BSAs (1+2+3)**	**ASEAN Swap Arrangement**	**Total CMI (4+5)**	**IMF quota**[b]	**Ratio (6/7)**
South Korea	2,000	2,000		4,000		4,000	2,058	1.9
Malaysia	1,000	[1,000]	[1,000]	[3,000]	300	3,300	1,873	1.8
The Philippines	3,000	[1,000]	1,000	[5,000]	300	5,300	1,108	4.8
Thailand	3,000	2,000	1,000	6,000	300	6,300	1,363	4.6
Singapore	[3,000]			[3,000]	300	3,300	1,087	3.0
Indonesia	[3,000]			[3,000]	300	3,300	2,620	1.3
Total	[15,000]	[6,000]	[3,000]	[24,000]	1,500	25,500	10,109	2.5
Ratio to quota	0.9	0.7	1.5					

ASEAN = Association of Southeast Asian Nations
CMI = Chiang Mai Initiative

a. Brackets indicate provisional figures.
b. Calculated at the December 31, 2001, exchange rate from the IMF *Annual Report*, September 2001, 188-91.

Sources: Compiled from IMF data, Rana (2002), Kuroda and Kawai (2002), and author's interviews.

Table 3.3 Swap arrangements under the Chiang Mai Initiative within Northeast Asia (millions of US dollars)

	Creditor country					
	(1)	(2)	(3)	(4)	(5)	(6)
Borrowing country	Japan	China	South Korea	Total BSAs	IMF quota[a]	Ratio (4/5)
Japan		3,000	2,000	5,000	16,771	0.3
China	3,000		2,000	5,000	8,024	0.6
South Korea	2,000	2,000		4,000	2,058	1.9
Total	5,000	5,000	4,000	14,000		

BSAs = Bilateral swap agreements

a. Calculated at the December 31, 2001, exchange rate from the IMF *Annual Report*, September 2001, 188-91.

Sources: Compiled from IMF data, Rana (2002), Kuroda and Kawai (2002), and author's interviews.

might be able to borrow almost five times its IMF quota. Thailand has access to more than four-and-a-half times its IMF quota through the CMI. South Korea's BSAs with Japan and China amount to almost twice its IMF quota, and its two-way swaps with ASEAN partners amount to about one-and-a-half times its IMF quota. Although the limits on members' access to IMF financing might be more strictly enforced in the future than they were during the period 1997-98, members may still borrow several multiples of their quota from the IMF.[31] The amounts available through the CMI thus appear to be roughly comparable to those formally available from the IMF.

Third, once the legal and operational framework of the swaps is in place, the numbers can be changed relatively easily—with the agreement of both parties. Swaps among the Group of Ten's central banks, which are discussed at some length below, were often increased in the midst of crises or currency operations in the 1960s and 1970s. When the United States mounted its major dollar rescue operation in 1978, for example, it more than doubled the size of its arrangements with the German Bundesbank, Bank of Japan, and Swiss National Bank from $7.4 billion to $15 billion.

31. The amount that can be borrowed under a standby arrangement and the Extended Fund Facility (EFF) is 100 percent of the member's quota annually and 300 percent cumulatively. Higher access can be granted in exceptional circumstances such as the program announced for Brazil in August 2002. Short-term financing in excess of these limits is also available from the SRF and CCL and, in smaller amounts, the Compensatory Financing Facility, Poverty Reduction and Growth Facility, and emergency assistance (IMF 2001a).

Current Agenda

At present and over the near term, ASEAN+3 is discussing "enhancing the effectiveness of our economic reviews and policy dialogues," or surveillance.[32] Outsiders might assume that East Asian officials have discussed economic policy as frequently and freely as, say, the Europeans did in earlier decades and Group of Seven officials do now. But the absence of such a dialogue until very recently is illustrated by a story told by Blustein (2001, 123) about the devaluation of the New Taiwan dollar in October 1997:

> The match took place at a golf course in Taipei, the capital of Taiwan, among a foursome that included Lee Kyung Shik, governor of the Bank of Korea, and Hsu Yuan Dong, governor of the Taiwanese central bank, which is called the Central Bank of China. The two bank chiefs spoke English with each other, but Hsu was conducting frequent, agitated conversations in Chinese over his mobile phone. "I knew it was something urgent, but I didn't know what," recalled Lee. "I thought, 'Is it a personnel issue?' I didn't know." Although Lee said he didn't expect to be told, it is astonishing that his golfing partner did not inform him of events, because the implications for the Korean economy would prove devastating.

With perhaps similar incidents in mind, ASEAN established its own surveillance mechanism in 1998 to monitor the economies of its members and to provide early warning of impending crises. The ASEAN Surveillance Coordinating Unit provides the analytical input to the process, which passes through meetings of finance ministry and central bank deputies before being reviewed at meetings of finance ministers. On the critical issues of whether the process can facilitate policy adjustment and/or limit financial crisis, the verdict is still out.[33]

By comparison, the governments of the region have been relatively slow to construct a surveillance process for ASEAN+3. The first peer-review surveillance meeting of the group was held in May 2000. After completing the first round of financial arrangements in 2001, the group devoted further attention to bolstering the process, creating a study group to review the modalities and requirements of an effective system. The Asian Development Bank, which had created a Regional Economic Monitoring Unit in 1999, took the initiative to develop a prototype early warning system for the region.[34] The ADB and ASEAN secretariats have been called upon to provide analytical input to recent ASEAN+3 meetings.

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32. ASEAN+3 communiqué, Honolulu, May 9, 2001. Asian officials prefer the phrase "policy dialogue" to the word "surveillance."

33. Manzano (2001).

34. Rana (2002).

Currently, the deputies from finance ministries and central banks of the ASEAN+3 gather once a year on an informal basis to conduct mutual surveillance. The first such meeting was held in Myanmar in April 2002. Deputy finance ministers meet at least two more times each year, and finance ministers meet at least once each year and can conduct policy reviews during those sessions as well.[35]

These arrangements represent only minimal progress, however. No consensus has been reached within the group on a number of important, basic questions surrounding the design of a permanent surveillance process. The responsibility for organizing the analytical papers for and presentations to the ministers and deputies, for example, currently rests with the host government. If ASEAN+3 is to develop a more robust surveillance mechanism, it will have to confront tough questions about information disclosure, staffing, institutional prerogatives, and the role of peer pressure.[36] Although reaching agreement might be difficult, the group has the benefit of prior examples of the IMF, the Organization for Economic Cooperation and Development, and the European Union and can build upon the existing surveillance mechanisms in the region, including those of the ADB, ASEAN, the Asia-Pacific Economic Cooperation forum, and the Manila Framework Group.

In the related area of monitoring short-term capital flows across the region, the group has also made some limited progress. Seven countries—Brunei, Indonesia, Japan, South Korea, the Philippines, Thailand, and Vietnam—have agreed to exchange data on capital flows on a bilateral basis, with some other countries showing interest in participating as well.[37] However, again, there is no consensus on a unified system for sharing information. Nor does there yet appear to be any mechanism for coordinating or aggregating the bilateral exchanges to compile a more comprehensive picture of capital flows in the region.

Exchange rate matters represent a particularly important subgroup of surveillance topics. Although the quality of dialogue on exchange rate matters has improved since the 1997-98 crisis, it has not prevented serious and public conflicts among ministerial officials. Japanese officials—having endured prolonged stagnation, and faced with a sharp recession during 2001-02—desired a weakening of the yen. As a by-product of domestic measures to stimulate the economy, downward pressure on the exchange rate of the yen was quite likely. In April 2001, for example, vice minister of finance Haruhiko Kuroda wrote in the *Wall Street Journal* that a gradual

35. "The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting," May 10, 2002, Shanghai.

36. Treatments of regional surveillance include Grenville (2001), Wang and Woo (2002), and Wang and Yoon (2002).

37. "The Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting," May 10, 2002, Shanghai.

depreciation would be acceptable to Japan.[38] The Chinese minister of finance and the Korean vice minister of finance said, by contrast, that they were greatly concerned about the depreciation of the yen.[39]

Undaunted, during the autumn, Japanese officials argued publicly that the renminbi, not the yen, was undervalued.[40] Toward the end of the year and the beginning of 2002, the yen depreciated from the low 120s to the mid-130s against the dollar, with a number of commentators predicting much further depreciation.[41] Other governments in the region, led by Chinese and Korean officials, once again objected vociferously.[42] There is clearly a need for more specific discussions among a larger number of key Asian officials about their expectations and perspectives with respect to exchange rate policy.

Alternative Futures

Looking beyond the immediate challenges of surveillance, it is useful to ask how the Chiang Mai Initiative could evolve over the long term. Although there is no agreement within the region at the moment on the direction that financial cooperation should take beyond the present arrangements, a variety of ambitious proposals are being discussed in academic settings. There are at least four possibilities.

First, the BSAs could be expanded in number to those countries not now participating in bilateral arrangements, increased in size to mobilize

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38. Haruhiko Kuroda, "A Falling Yen Is Nothing to Fear," *Wall Street Journal*, April 10, 2001, A22.

39. See, e.g., Phillip Day and Jason Booth, "Japan's Neighbors Want Yen's Slide to Be Halted," *Asian Wall Street Journal*, April 4, 2001, 1.

40. "Shiokawa: Expect Talks on Eventual Free Float of Yuan" and "Inside View: BOJ Wooing China for a Boost to Yuan Value," *Nihon Keizai Shimbun*, November 28 and 5, 2001, respectively, at http://www.nni.nikkei.co.jp.

41. Former vice minister Sakakibara speculated openly about the yen-dollar rate moving to 150-60 (*Financial Times*, January 16, 2002, 16) and *The Economist* (February 16, 2002) wrote that there was a consensus among economists that, assuming mild inflation were restored in Japan, 180-200 was a more appropriate long-term range for the exchange rate.

42. The governor of the People's Bank of China, Dai Xianglong, warned that continued yen depreciation could create "a domino effect of depreciations in Asia," Dow Jones International News, January 15, 2002. A state-backed Chinese newspaper called the yen depreciation "irresponsible," while a Foreign Ministry spokesperson called on Tokyo to "take responsibility" to stabilize the region economically; *Financial Times*, December 27 and 28, 2001, 6 and 1, respectively. The Korean minister of foreign affairs and trade, Han Seung-Soo, also warned of serial depreciation in the region, while the minister of finance and economy said further yen depreciation would be "disastrous"; *Dow Jones Capital Markets Report*, December 2001, and Dow Jones Business News, January 15, 2001.

a larger share of the reserves held within the region, and / or broadened in geographic scope beyond the current 13 members of ASEAN+3. By coordinating the terms and activation, the bilateral swaps could be upgraded into a genuine network. Such an enlargement of the BSAs, though, would probably depend on the willingness of members to submit to regional surveillance. The most ambitious of such proposals envision the creation of an Asian Monetary Fund, wherein governments and central banks pool their reserves centrally and cede control to an executive board composed of their appointed representatives. (The merits of these proposals are discussed at greater length in chapter 7, which offers a number of recommendations.)

Second, were surveillance to be indeed strengthened, it is possible that the group could develop the capability of defining its own policy conditions for medium-term swaps. Certainly, although they are in the minority at the moment, some members of the group would propose this course of action. Though continuing to coordinate their operations with the IMF broadly, the group might eventually consider eliminating the formal requirement that a borrower negotiate access to an IMF facility in order to activate most of the BSAs or successor arrangements (also discussed in chapter 7).

Third, national authorities might wish to pursue regional exchange rate stabilization, through proposals such as joint pegging to a common basket of currencies and arrangements similar to the European Monetary System. These and more ambitious schemes would require closer coordination of monetary policies and enhancements to regional financial facilities. Common currencies for subregions or East Asia as a whole could ultimately be envisioned.

Fourth, it must be acknowledged that, possibly, the BSA framework of principles and the bilateral agreements could simply be dismantled. Such an outcome, in the judgment of the author, is unlikely unless the risk of financial crises falls unexpectedly or the BSAs prove to be counterproductive in some unforeseen respect. Finance ministries and central banks will have the opportunity to dismantle, extend, or enlarge these arrangements when they review the CMI in 2004, as they have agreed to do.

Broader Implications

After the announcement of the agreement on the first set of BSAs in May 2001, the *Financial Times* described the result as "symbolic."[43] *The Economist* opined that the size of the swap arrangements would "not terrify the currency markets" and that the swaps "provide a degree of psychological comfort," but "the best hope for these defences is that they

43. *Financial Times*, May 10, 2001, 16.

should never actually be tested."[44] C. Fred Bergsten, by contrast, describes the CMI as part of a broader process leading to an Asian Monetary Fund and regional monetary arrangements. He confidently concludes that, when combined with trade regionalism, "there can be little doubt that these movements will result in the evolution of an East Asian economic bloc."[45] The evidence to date suggests that the CMI will be considerably more than symbolic, especially once all of the bilateral swaps described in table 3.1 are completed, but far less than an economic bloc.

The CMI does not create a new institution, nor does it pool the reserves of countries in the region under central management.[46] Contrary to the hopes of enthusiasts for regional cooperation, the CMI does not even mobilize a substantial fraction of the foreign exchange reserves of the Northeast Asian three. Nor do the BSAs constitute a network, beyond the limited sense of being activated jointly. Surveillance remains to be developed into a mechanism that can head off crises or correct policy errors on the part of member governments, and the exchange rate policy dialogue in particular needs strengthening.

At the same time, the CMI provides financial resources that are collectively substantial and supplements the resources available within the region through the NMI. Perhaps more important, the bilateral swap arrangements provide a focus for concrete negotiations, periodic reviews among officials within the region, and the basis for building serious policy dialogue. These advances are in fact path-breaking: Officials within the region have never before had such intensive, continuous negotiations and policy dialogue on a regional basis on monetary and financial matters.

The CMI is thus significant for both the resources that it can bring to crisis prevention and stabilization and for its potential to develop into a stronger set of institutions in the future. The ASEAN+3 meetings—the foremost being the regional summits—the financial arrangements, and consultative processes provide a basis upon which further regional monetary and financial cooperation can evolve. Such an evolution depends not only on financial developments but also on political developments within the region and on developments outside East Asia.

Prospects

Asian governments do not agree about the future pace, extent, and direction of regional financial cooperation. Those differences largely correspond to differences in their size, economic development and structure,

44. *The Economist*, May 12, 2001, 73.

45. Bergsten (2001).

46. The latter was proposed in Park (2000).

external trade and investment relations, and political institutions, among other factors, which confer substantially different interests on countries. The relationship between Japan and China—some would say rivalry—is central to the evolution of regional arrangements, whether economic or political.

By virtue of its spectacular growth before the 1990s, Japan dominates regional trade and finance. Its decade-long stagnation and increasing financial fragility, however, constrain its ability to secure the agreement of others in the region to its proposals. East Asian integration could help to institutionalize and legitimize this influence, but Japan needs Chinese acquiescence to regionwide arrangements. Japan is also wary of serving as an indulgent creditor.

China, by contrast, has been growing at relatively high rates. Although its economy faces several major adjustment challenges, Chinese officials expect to have more regional economic influence in the future than they do at present and are thus reluctant to lock in institutional arrangements that embody present power relations. Yet China can benefit substantially from regional trade and investment, and it wishes to assuage concerns about its growing economic power. For these reasons, Chinese officials have been drawn to regional trade and financial proposals.

South Korea and ASEAN members typically seek to involve both Japan and China in regional arrangements in order to avoid choosing between the two powerful regional actors. Korea and the Southeast Asian countries are wary of Japanese economic dominance but are increasingly concerned about the economic "threat" from China, particularly in the wake of Chinese accession to the World Trade Organization. Proposals for trade liberalization among varying subregional configurations have proliferated. Viewing financial agreements as complements to trade initiatives, and conscious of their vulnerability to financial crises, both Korea and ASEAN members perceive benefits to financial cooperation.

Political disagreements and potential security conflicts threaten to impede economic cooperation. Divisive potential flashpoints include cross-strait relations, North Korea, civil conflict in Indonesia and other countries, territorial disputes in the South China Sea, repercussions of the war on terrorism, and, of course, the legacy of Japanese occupation before and during World War II. Despite the enthusiasm on the part of proponents of East Asian regionalism, consequently, there is nothing inevitable about the future development of regional financial institutions.

However, the region's countries also have interests that are compatible: interdependence of markets, intraregional investment, and mutual vulnerability to financial contagion, among others. For these reasons, potential disagreements will not necessarily block the development of regional financial cooperation. With the CMI agreements, ASEAN+3 has created for itself an option that it did not possess a few years ago: to build upon these arrangements if governments in the region are dissatisfied with their treatment by governments outside the region and multilateral institutions in future crises.

Consider, in this regard, the evolution of European monetary integration. At its inception, the European Community almost completely dismissed monetary cooperation as a regional project because the stability of European currencies was provided for under the Bretton Woods regime. As that regime broke down, however, and Europe repeatedly clashed with the United States over macroeconomic policy, the balance of payments, and exchange rates, regional monetary integration was given greater priority.

The first significant attempt to stabilize exchange rates on a European basis—the snake—was not impressive either. European governments held widely divergent macroeconomic objectives during the 1970s, and correspondingly divergent preferences with respect to monetary integration, just as Asian officials now hold divergent preferences on financial matters. Transatlantic monetary disputes nonetheless drove European governments into one another's arms. It is significant that each major episode of transatlantic conflict was followed by a serious European monetary initiative; backsliding in the European theater followed periods of transatlantic tranquility.[47]

Notwithstanding large differences between the regions, the development of Asian financial cooperation is likely to follow a path that is similarly contingent on shocks. If financial shocks to Asian economies are insignificant or very rare, or if shocks come primarily from within the region (especially from Japan or China), the impetus for regional cooperation is likely to flag. If shocks are substantial and more frequent—which is more likely to be the case—yet the reforms to international financial institutions prove adequate to provide a rapid and robust response, Asian governments are also less likely to enhance regional cooperation. But if extra-regional shocks persist and Asian governments are dissatisfied with the multilateral response, they will have regional arrangements on which to build and a powerful incentive to do so. The more disruptive the shocks and the less adequate the multilateral response, the more likely that East Asian governments will overcome intraregional conflicts over cooperation.

47. See Henning (1998).