The stringent conditions the International Monetary Fund imposed on Asian countries seeking bailouts during the 1997-1998 financial crisis left a bitter legacy. Countries in the region later banded together to create regional financial safety nets that would begin to give them greater ability to help themselves.

That process of building and strengthening regional safety nets is far from over, but Pradumna B. Rana and Ramon Pacheco Pardo argue it’s now time for these regional initiatives and the IMF to co-operate more closely for the good of the global financial system.

The Need for a Marriage of Convenience

By Pradumna B. Rana & Ramon Pacheco Pardo

CAN THE Association of Southeast Asian Nations plus China, Japan and South Korea (ASEAN+3) prevent and resolve financial crises without external help?

Following the Asian Financial Crisis of 1997-1998, policy-makers in ASEAN+3 launched several “self-help” regional mechanisms, mainly because of the slow response of the International Monetary Fund to the crisis. Yet, these mechanisms were not used when the global financial crisis hit East Asia in 2008. The countries in the region seeking outside help resorted instead to their bilateral swap arrangements with the US Federal Reserve. Since then, existing regional mechanisms have been strengthened and new ones developed, in the hope that they will be used in the future, if necessary. The introduction of a strengthened regional financial safety net (RFSN) would suggest that eventually the IMF would be irrelevant in East Asia.

Yet, there is an ongoing discussion regarding the relationship between regional safety nets and the global financial safety net of which the IMF is a central part. Several authors have argued that global and regional nets should complement each other, while others have noted that they should be standalone and independent. Focusing on the case of the ASEAN+3 safety net and the IMF, we argue that the two must complement rather than duplicate each other for greater efficiency. However, the present ad hoc method of promoting complementarity between ASEAN+3 and the IMF is not adequate to stem the newer types of crises associated with financial globalization. A more structured form of cooperation between ASEAN+3 and the IMF is needed, similar to the one in Europe. At least for the time being, ASEAN+3 does not have an independent crisis prevention and solving capability.

THE CURRENT STATE OF PLAY

In their May 2000 joint statement, the ASEAN+3 ministers stipulated that the regional safety net in East Asia should “supplement the existing international facilities.” The way this was promoted in the Chiang Mai Initiative Multilateralisation (CMIM) — and its predecessor, the Chiang Mai Initiative (CMI) — was by requiring the existence of an IMF-supported program to provide assistance in excess of a certain percentage of the maximum access to the currency swaps in the regional safety net. Initially, only 10 percent of this maximum access was readily available, with 90 percent linked to an IMF program. The size of the delinked portion was subsequently increased to 20 percent in 2005. The link to the IMF was intended to address the moral hazard problem in lending and the lack of independent surveillance capacity under the CMI. By 2008, the ASEAN+3 countries had signed 16 bilateral swaps among each other amounting to a total of US$86 billion.
In the aftermath of the severe credit crunch that the region experienced because of the 2008 global financial crisis, the CMI bilateral swaps were not used. This was because of the small size of the swaps — including the delinked portions — and the absence of a rapid response mechanism to trigger the swaps, given that each bilateral swap had to be activated one at a time. For example, the Philippines and Thailand had two swaps each with Japan and South Korea for US$2.5 billion and US$4 billion, respectively, and it would have taken several weeks or even more to activate them.

Since then, ASEAN+3 has taken a number of actions to increase financial resources available from its regional safety net and to clarify the disbursement procedures. These include multilateralising the CMI to CMIM, doubling the size of the CMIM; increasing the delinked portion to 30 percent with a view to increasing it further to 40 percent, subject to review; establishing the ASEAN Macroeconomic Research Office (AMRO); and agreeing to a decision-making process and operational guidelines. These include multilateralising the CMI to CMIM, doubling the size of the CMIM; increasing the delinked portion to 30 percent with a view to increasing it further to 40 percent, subject to review; establishing the ASEAN Macroeconomic Research Office (AMRO); and agreeing to a decision-making process and operational guidelines.

Actions taken to strengthen the ASEAN+3 Regional Financial Safety Nets since the Global Financial Crisis

1. The CMI has been multilateralised into the CMIM.

   In March 2010, the bilateral swaps were combined and expanded to become the Chiang Mai Initiative Multilateralisation (CMIM) or the US$120 billion “self-managed reserve pool” governed by a single contract. As a self-managed reserve pool, the contributions remain in the central banks of the member countries and are not actually paid into a centralised reserve pool. Two years later the size of the pool was doubled to US$240 billion.

2. Contributions, borrowing rights and operational guidelines of the CMIM have been fixed.

   All ASEAN+3 member countries (plus Hong Kong) have contributed to the CMIM and are eligible to borrow from it using a multiplier (so smaller countries can borrow more), in case they face a payments problem. To access the CMIM, a member country must submit a request to the Co-ordinating Countries (the co-chairs of ASEAN+3), which then deliver the request to a non-resident Executive Level Decision-making Body. This body then has to convene and take a decision based on a two-thirds majority within two weeks from the receipt of the swap request.

3. AMRO has been established and its capacity is being enhanced.

   With the multilateralisation of the CMI, there was a need for an independent surveillance unit to conduct due diligence so that the borrowing countries’ capacity to repay the loan could be assessed. In May 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was established as a limited company in Singapore. Its activities are divided into functions during so-called peace time and crisis time.

4. Several other decisions were taken at the May 2012 meeting of the ASEAN+3 Finance Ministers:

   (a) The delinked portion was increased to 30 percent with a view to increase it to 40 percent subject to review should conditions warrant.
   (b) The ASEAN+3 Finance Ministers Meeting was upgraded to the ASEAN+3 Finance Ministers and Central Bank Governors Meeting. For the first time, the central bank governors of the 13 countries plus the head of the Monetary Authority of Hong Kong were invited to participate in the forum. This was a significant move, because it brings together officials handling tax/expenditure policies with those handling monetary and exchange rate policies.
   (c) A crisis preventive facility similar to various contingent credit lines at the IMF, the CMIM Precautionary Line (CMIM-PL), was introduced.
still insufficient to prevent and solve a financial crisis. Structured collaboration with the IMF could significantly strengthen financial crisis prevention and resolution in the region, bringing both the CMIM and AMRO to the center of efforts to foster financial stability in East Asia and beyond. For its part, the IMF would also benefit from co-operation with ASEAN+3. This would ensure that it does not become irrelevant in one of the biggest and most economically dynamic regions in the world.

There are three areas in which co-operation between ASEAN+3 and the IMF is achievable in a relatively short period of time.

First, as in Europe, ASEAN+3 countries seeking financial resources should be required to apply simultaneously to both the CMIM and the IMF, and AMRO and the IMF should jointly analyze and evaluate the applications. Currently, the analysis and evaluation by the two institutions are separate, with AMRO responsible for CMIM funds. But AMRO’s capacity is limited and it will take a long time to strengthen it.

Involving both AMRO and the IMF in the analysis and evaluation process would increase its robustness in two ways. First, experts from outside East Asia would support an understaffed AMRO, which would nonetheless arguably be less politicized than any meeting of CMIM members. Decisions on applications could therefore be made more rapidly, and would involve IMF staff who, at least in theory, should feel more dispassionate about the country requesting a CMIM package. A crisis triggering an application for CMIM funds would need a decision in the shortest period of time and with the smallest moral hazard possible. AMRO and IMF intervention in the decision-making process would help both.

In addition, joint application to both the CMIM and the IMF would help address the IMF stigma in East Asia. Given the experience of Indonesia, South Korea and Thailand during the 1997 Asian Financial Crisis, it would be very difficult politically to sell an IMF program anywhere in East Asia. Having a joint process together with an ASEAN+3 institution — namely, AMRO — would eliminate the potential duplication in terms of applications, while also lessening the political fallout of any program the IMF might want to impose.

The second area in which co-operation would be relatively easy to develop is joint financing and supervision of CMIM-approved liquidity provision programs. Currently, financing would only come from the CMIM pool, which, as already explained above, would probably be insufficient to avert the spread of a financial crisis. Combining the resources of the CMIM together with those of the IMF would substantially increase the resources available for ASEAN+3 to deal with a financial crisis. As the experience of joint EU-IMF programs shows, the percentage of a total rescue package coming from the regional safety net and the IMF can be negotiated on a case-by-case basis. This model would give ASEAN+3 countries the flexibility to decide how much to ask the IMF for.

Meanwhile, joint supervision of any approved liquidity provision program would be the natural consequence of joint approval and financing. Yet, even if approval stayed separate and financing were to remain solely in the hands of ASEAN+3, joint supervision would make sense. At present, supervision in theory would be doubled. AMRO would supervise compliance with the terms of the delinked portion of any program, with the IMF dealing with the portion linked to its adjustment program. It seems clear that the country receiving a rescue package would find it more difficult to address two different supervision regimes, especially at a time of economic stress. A joint supervision process would significantly ease the burden on a government that should be more worried about the actual implementation of a crisis-resolution program.

Finally, there is a third area in which co-operation between ASEAN+3 and the IMF would be beneficial for both, but especially for the former. This is complementary financial surveillance of ASEAN+3 members, a crucial crisis prevention mechanism. Since its establishment in April 2011, AMRO has been tasked with producing quarterly assessments of each ASEAN+3 economy, as well as a macroeconomic report for the whole region. On paper, member reports are not very different from the annual reports published by the IMF, following consultations under Article IV of the Fund’s Agreement. The main differences relate to their frequency — quarterly vs. annually — and the fact that AMRO reports are not made public, which according to some finance and central bank officials of ASEAN+3 countries fosters a more honest discussion.

Given that AMRO and IMF reports have the common goal of ensuring that signs of financial stress are caught well enough ahead of time to prevent a possible crisis, it would make sense for the two institutions to combine their capabilities. AMRO, as already noted, has a small staff. But they all come from ASEAN+3 member countries, giving them familiarity with one or more countries in the region, including relevant language skills and cultural understanding. For its part, the IMF is better-resourced and has staff with knowledge about financial systems in different parts of the world. Pulling their resources together through joint AMRO-IMF missions and analysis would strengthen the surveillance mechanism.

**EUROPE AND THE IMF: A BLUEPRINT FOR CO-OPERATION?**

ASEAN+3 and the IMF, therefore, need to develop a more structured form of co-operation to pool financial and technical resources. An
example worth considering is the IMF’s co-operation with European regional financial safety nets to resolve the Eurozone crisis. In Europe, countries that are members of both the EU and the IMF request financial assistance simultaneously from the two institutions. In the case of assistance to EU members outside of the Eurozone, discussions are conducted jointly with the government authorities, the European Commission (EC), and the IMF. In addition, the European Central Bank (ECB) participates in the discussions when the borrowing country is in the Eurozone, forming the “Troika” framework among the IMF, EC and ECB.

In designing policies and conditions, there is a clear division of labor, with the IMF focusing on the macroeconomic framework, the EC ensuring that the conditionality is consistent with EU-wide rules and institutions (particularly with the fiscal targets), and the ECB ensuring that the financial sector strategy is sufficiently robust. The Troika members discuss the program among themselves before presenting it to the authorities. Two separate program documents are prepared, one for the IMF board and another for the EC.

Programs are co-financed, with no single rule for burden sharing between the IMF and European safety nets. In Latvia in 2008 and Greece in 2012, the IMF provided about 20 percent of the total financing, while European safety nets provided the balance. On the other hand, in Hungary in 2008 and Romania in 2009 and 2011, the IMF provided over 60 percent of the financing. The IMF’s assessment of this co-operation is that although the difference of views among institutions continues to pose challenges, “on the ground, the Troika structure has enabled effective information sharing, more streamlined program discussions and reviews, and helped ensure that external communications are well co-ordinated.”

The IMF model has not been without its problems. Most notably, politicians and citizens in some of the bailout recipient countries have complained that the austerity measures imposed by the Troika are too onerous. However, from a technical point of view, this model has at least served to make clear who does what, and to whom the recipient country has to answer.

There is no reason to think that this model could not serve as a blueprint for ASEAN+3 and the IMF to strengthen their co-operation. An option would be the joint development of conditionality for financing, with the IMF focusing on the macroeconomic framework and AMRO on regional issues, particularly on matters relating to financial and capital market development. ASEAN+3 has built up competencies in this area because of the ASEAN+3 Bond Market Initiative. A bailout recipient country would therefore have a single set of conditions to meet and only be answerable to a joint AMRO-IMF body.

**CONCLUSIONS**

The present ad hoc method of co-operation between ASEAN+3 regional safety nets and the IMF is unlikely to be successful. A more structured form of co-operation between the two institutions should, therefore, be considered. This framework should involve pooling of financial and technical resources in three areas: (i) joint AMRO-IMF analysis and evaluation of all applications for CMIM liquidity; (ii) co-financing of programs by the ASEAN+3 safety nets and the IMF, with the amounts determined on a country-specific basis; and (iii) complementary surveillance of ASEAN+3 members to prevent financial crises.

The timing is also appropriate for a more structured form of complementarity between the ASEAN+3 safety nets and the IMF. After the Asian Financial Crisis, countries in the region suffered from the IMF stigma that originated from the feeling of being unfairly treated and being forced to accept inappropriate conditions. This is now changing and the IMF is invited to the surveillance meetings of the ASEAN+3 ministers, together with AMRO. The IMF has also engaged in dialogues with AMRO as part of its outreach activities, although it does not have a formal technical assistance program with it. This engagement should be deepened further in a more structured form, as outlined above. The IMF should not reject such offers, because it would be seen as being too Euro-centric. A few years back, former IMF economist Arvind Subramanian, remarking on European domination of the Fund, said the IMF was not an international but a Euro-Atlantic monetary fund.

Regardless of whether policy-makers in ASEAN+3 would like the CMIM and AMRO to be fully independent from the IMF or not, at present this is not the case. Crisis prevention and resolution need to take precedence over independent capabilities for the foreseeable future. Since the IMF has already established links with ASEAN+3 and formally co-operated with the EU, it would not be too complex to institutionalize relations with the CMIM and AMRO. This would be to the benefit of financial stability in East Asia and reduce the contagion to the rest of the world.