

Regional Monetary Cooperation in East Asia

Should the United States Be Concerned?

A Report of the CSIS Freeman Chair in China Studies

AUTHORS

Wen Jin Yuan
Melissa Murphy

PROJECT DIRECTOR

Charles W. Freeman III

November 2010



Regional Monetary Cooperation in East Asia

Should the United States Be Concerned?

A Report of the CSIS Freeman Chair in China Studies

AUTHORS

Wen Jin Yuan

Melissa Murphy

PROJECT DIRECTOR

Charles W. Freeman III

November 2010

About CSIS

In an era of ever-changing global opportunities and challenges, the Center for Strategic and International Studies (CSIS) provides strategic insights and practical policy solutions to decisionmakers. CSIS conducts research and analysis and develops policy initiatives that look into the future and anticipate change.

Founded by David M. Abshire and Admiral Arleigh Burke at the height of the Cold War, CSIS was dedicated to the simple but urgent goal of finding ways for America to survive as a nation and prosper as a people. Since 1962, CSIS has grown to become one of the world's preeminent public policy institutions.

Today, CSIS is a bipartisan, nonprofit organization headquartered in Washington, D.C. More than 220 full-time staff and a large network of affiliated scholars focus their expertise on defense and security; on the world's regions and the unique challenges inherent to them; and on the issues that know no boundary in an increasingly connected world.

Former U.S. senator Sam Nunn became chairman of the CSIS Board of Trustees in 1999, and John J. Hamre has led CSIS as its president and chief executive officer since 2000.

CSIS does not take specific policy positions; accordingly, all views expressed in this publication should be understood to be solely those of the author(s).

© 2010 by the Center for Strategic and International Studies. All rights reserved.

ISBN 978-0-89206-617-9

Center for Strategic and International Studies
1800 K Street, N.W., Washington, D.C. 20006
Tel: (202) 775-3119
Fax: (202) 775-3199
Web: www.csis.org



REGIONAL MONETARY COOPERATION IN EAST ASIA SHOULD THE UNITED STATES BE CONCERNED?

Wen Jin Yuan and Melissa Murphy

After a decade of negotiations revolving around regional monetary cooperation, the Association of Southeast Asian Nations (ASEAN) plus China, Japan, and South Korea (ASEAN+3) finally reached agreement to establish a regional foreign reserve pool in February 2009. The launch of the Chiang Mai Initiative Multilateralization (CMIM) came amid the global financial crisis, when the ASEAN nations hit so hard during the 1997 Asian financial crisis were once again reminded of the utility of a joint policy initiative to ensure regional financial stability.

The formation of the Asian foreign reserve pool has, however, not been greeted with universal enthusiasm. While ostensibly a regional financial matter, its wider economic and geopolitical implications are still being debated. Three major concerns have been raised—first, that the formation of the Asian foreign reserve pool will undermine the role of the International Monetary Fund (IMF) as lender of last resort during a financial crisis. Second, some, particularly in the United States, worry that as Asian regional monetary cooperation moves forward, it will negatively impact U.S. interests and diminish U.S. influence in East Asia, a region of increasing strategic importance to Washington in view of Beijing's rise. Third, and of utmost concern to many, is China's role in this new regional monetary cooperation mechanism and its potential impact on the region's delicate geopolitical balance.

Given the high financial, economic, and geopolitical stakes, this report examines the validity of these concerns—particularly China's motivations as the main backer of the CMIM—and to ascertain what the implications are for the United States down the road.

A Regional Port in a Global Financial Storm

Ever since the Asian Financial Crisis hit the region in 1997, there has been a great deal of interest in enhancing regional economic cooperation. Immediately after the 1997 financial crisis, ASEAN reached out to China, Japan, and South Korea (ASEAN+3) in search of a joint policy initiative aimed at ensuring regional financial stability. China was the main supporter of this initiative. After several years of negotiation, the Chiang Mai Initiative (CMI) was launched in May 2000.

The most important component of the CMI was a network of bilateral swap agreements (BSAs) among the ASEAN+3 nations, which supplemented the international financial facilities in place at that time. However, the total size of the BSAs proved inadequate to boost investor confidence and to prevent ASEAN countries from speculative attacks during a financial crisis. As of April 2009, the aggregate credit swap lines of US\$90 billion in BSAs among all 13 participant

The authors would like to thank the Chinese scholars who agreed to be interviewed for this report. We have respected their preference to remain anonymous and therefore do not cite them by name.

countries—while continuing to grow—still pales in comparison to the crisis packages offered to Korea, Indonesia, and Thailand by the IMF in 1997–1998.¹

Among the ASEAN+3 nations, China has always actively pushed for the BSAs to evolve into a “multilateral mechanism.” In October 2003, Chinese premier Wen Jiabao first announced Beijing’s proposal to “propel the bilateral swap agreements into a multilateral Chiang Mai Initiative.”² At the ASEAN+3 finance ministers’ meeting in 2006, a working group, chaired by China and Thailand, was formed to “analyze the possibility of propelling the multilateralization of the Chiang Mai Initiative.”³ However, little progress was made until the 2008 global financial crisis.

The 2008 crisis again raised concerns about regional financial stability in East Asia. At the finance ministers meeting in February 2009, the ASEAN+3 countries finally reached agreement to transform the existing BSAs into a regional foreign reserve pool of US\$120 billion to “address short-term liquidity difficulties in the region and to supplement existing international financial arrangements.”⁴ The foreign reserve pool, known as the Chiang Mai Initiative Multilateralization (CMIM) was formally put into operation in March 2010.⁵ (See box 1.)

The establishment of the Asian foreign reserve pool has, however, raised several major concerns internationally—first, that it will undermine the role of the International Monetary Fund (IMF) as lender of last resort during a financial crisis. As Barry Eichengreen, professor of economics at the University of California, Berkeley, points out, “There has never been a question about the ultimate purpose of the Chiang Mai Initiative (CMI) That purpose, of course, is to create an Asian Monetary Fund, i.e., a regional alternative to the International Monetary Fund, whose tender ministrations during the 1997-98 financial crisis have not been forgotten or forgiven.”⁶ With multilateralization of the CMI, there is growing fear among some that if any of the participant countries suffers even a short-term liquidity problem in a future crisis, the country could seek help from the regional Asian foreign reserve pool rather than turning to the IMF.

Second, there are concerns, particularly among some in the United States that, as Asian regional monetary cooperation moves forward, it will negatively impact U.S. interests and diminish U.S. influence in East Asia, a region of increasing strategic importance to Washington in view of Beijing’s rise. According to Fred Bergsten, director of the Peterson Institute for International Economics, “We are headed inexorably and eventually toward an Asian bloc: an Asian group in certainly economic terms that will be the biggest part of the world economy.”⁷ Bergsten warns that

1. Bank of Japan, “The Agreement on the Swap Arrangement under the Chiang Mai Initiative (as of October 16, 2009),” October 16, 2009, <http://www.boj.or.jp/en/type/release/adhoc09/data/un0910a.pdf>.

2. Zhou Yu, “DongYa Jinrong HeZuo De Licheng Yu ZuiXin Dongxiang Fenxi” (Financial Cooperation among East Asian Countries: History and Recent Development), *Dangdai Shijie*, June 2009, <http://www.sass.org.cn/sass/eWebEditor/UploadFile/00n/ull/20091215100932781.pdf>.

3. Ibid.

4. Joint Media Statement from the Finance Ministers Conference in Phuket, Thailand, “Joint Media Statement—Action Plan to Restore the Economic and Financial Stability in the Asian Region,” February 22, 2009, http://www.mof.go.jp/english/if/as3_090222.pdf.

5. Joint Ministerial Statement from the 13th ASEAN+3 Finance Ministers’ Meeting in Tashkent, Uzbekistan, “The Joint Ministerial Statement of the 13th ASEAN+3 Finance Ministers’ Meeting,” May 2, 2010, http://www.aseansec.org/documents/JMS_13th_AFMM+3.pdf.

6. Barry Eichengreen, “Can Asia Free Itself from the IMF?” *Project Syndicate*, June 22, 2009, <http://www.project-syndicate.org/commentary/eichengreen6/English>.

7. C. Fred Bergsten, “Asia-Pacific Regional Economic Integration and Architecture,” Speech delivered via video at the conference on Asia-Pacific Regional Economic Integration and Architecture at Auckland

this will “discriminate against outsiders causing negative economic effects on them; and with respect to the United States and this side of the Pacific Ocean, it does raise the specter of ‘drawing a line down the middle of the Pacific’ in the memorable term that Secretary of State Jim Baker enunciated over 20 years ago.”⁸

And, last but not least, what role China will play in this new Asian foreign reserve pool and how this will influence the delicate geopolitical balance in the region is of utmost concern to many. According to Ernest Bower, CSIS senior adviser and director, CSIS Southeast Asia Program, Chinese trade, investment, aid and foreign policy “suggest a strong inclination to see the region as within its sphere of influence—covered by China’s own version of the Monroe Doctrine.” And, it is this “Beijing perspective, not widely articulated but conveyed through posture, profile and persistence that causes concern among the Southeast Asian nations and warrants the constant attention and concern of U.S. policy makers.”⁹

To assess the likely impact of the pool on the IMF’s role in the international financial systems as well as the implication for U.S. economic and geopolitical interests in the region, we must first consider China’s motivations in pushing for formation of the Asian foreign reserve pool.

Box 1: The CMIM

The Chiang Mai Initiative Multilateralization (CMIM) Agreement establishes a reserve pool (the Asian foreign reserve pool) from which a member country can swap its national currency for U.S. dollars within a predetermined maximum amount, with the purpose of providing short-term liquidity assistance to member countries during a serious financial crisis. The CMIM evolved from the Chiang Mai Initiative (CMI), which was a series of bilateral swap arrangements among the ASEAN+3 member countries.

The total amount in the Asian Foreign Reserve Pool is US\$120 billion. Among them, the “Plus Three” countries of China, Japan, and South Korea contributed 80 percent, while the 10 ASEAN countries share the remaining 20 percent. Of the total amount, Japan contributed US\$38.4 billion to the pool, as did China (in conjunction with Hong Kong), while Korea contributed US\$19.2 billion. Within ASEAN, the contributions of the member economies were primarily by Indonesia, Malaysia, Thailand, Singapore (each contributing US\$4.76 billion) and the Philippines (US\$3.68).

What Is China’s Stake in the CMIM?

In the midst of the 2008 financial crisis, a number of ASEAN+3 countries, including Indonesia, Malaysia, and South Korea, faced short-term liquidity problems—that is, their central banks did not possess enough U.S. dollar reserves to cover demand by traders. At the annual ASEAN finance ministers’ conference, participants were therefore eager to support the establishment of a multi-lateral mechanism through which to cushion the short-term liquidity risk they were facing and might encounter again in the future.

University, New Zealand, March 25, 2010, <http://www.iie.com/publications/papers/paper.cfm?ResearchID=1525>.

8. Ibid.

9. Ernest Bower, Testimony before the U.S.-China Economic and Security Review Commission, “China’s Activities in Southeast Asia and Implications for U.S. Interests,” February 4, 2010, at http://www.uscc.gov/hearings/2010hearings/written_testimonies/10_02_04_wrt/10_02_04_bower_statement.php.

China, however, faces no such liquidity problems. Its foreign reserves, which have increased steeply since 2000, reached US\$2.447 trillion in March 2010 and now account for nearly one-third of the world's total; around 70 percent is reportedly held in U.S. dollars. Moreover, since China is under a managed exchange rate regime, with the renminbi pegged to the dollar as long as the United States remains China's major trading partner and transactions are still denominated in dollars, China will continue to build dollar reserves as its trade surplus grows. These foreign reserves are more than sufficient to shield China from speculative attacks if a financial crisis hits Asia again. From a purely financial perspective, it would, therefore, appear that China does not share its neighbors' motivations for establishing a foreign reserve pool.

Viewed from a wider economic as well as geopolitical perspective, however, China's motivations become apparent. First, China has a strong interest in seeking to prevent its ASEAN neighbors from economic collapse. In part this is due to the increasing importance of trade ties between China's southwestern provinces and the bordering ASEAN countries. Compared to the booming east-coast seaboard, economic development in China's southwestern region, including Guangxi, Yunnan, and Sichuan Provinces lags behind. With per capita GDP in the southwest some 30 percent less than China's coastal areas, domestic demand cannot be relied on to absorb locally produced goods. Moreover, high logistics costs hinder these goods from being competitive either within China's national market or overseas. Given the region's geographical proximity to China's ASEAN neighbors, one solution to the problem of economic development has been to develop a regional market. Exports from Southwestern China to ASEAN countries have increased dramatically from US\$1.04 billion in 2000 to US\$4.26 billion in 2007 and continued to grow at a steady pace despite the 2008 financial crisis.¹⁰

An economic downturn among its ASEAN neighbors—resulting in falling demand—would therefore negatively impact China's own economy, hitting particularly hard in an already impoverished and socially unstable region of the country. Viewed from this perspective, China has a strong motivation to support the establishment of financial mechanisms that are aimed at forestalling regional economic instability.

Second, notwithstanding recent disputes over maritime territorial claims, in the past decade China has been engaged in a diplomatic "charm offensive" aimed at reassuring its Asian neighbors that it is embarked upon a purely "peaceful rise."¹¹ Through actively participating in regional and multilateral organizations, Beijing has attempted to show that it is a constructive partner in the international community and a reliable bilateral partner. Support for an ASEAN foreign reserve pool is, therefore, consistent with China's overall proactive foreign policy posture in the region.

Third, it is possible that China is hoping to use the regional foreign reserve pool as leverage to win stronger bargaining power within the IMF. In recent years, while China's overall GDP has grown rapidly, its voting rights in the IMF have not increased commensurately. Prior to June, 2010, China's voting right was 3.65 percent. China's voting right, though augmented to 3.807 per-

10. Wei Sujie and Li Limin, "ZhongGuo Xinan Yu Dongmeng Chanye Nei Maoyi de Jingji Xiaoyi Fenxi" (The Economic Impact of Trade Between Southwestern China and ASEAN Countries), *Lunwen Wang*, 2007, <http://www.14edu.com/jingji/gjmy/0304L52010.html>.

11. Bonnie S. Glaser and Melissa Murphy, "Soft Power with Chinese Characteristics: The Ongoing Debate," in *Chinese Soft Power and Its Implications for the United States*, ed. Carola McGiffert (Washington, D.C.: CSIS, March 2009), http://csis.org/files/media/csis/pubs/090403_mcgiffert_chinesesoftpower_web.pdf.

cent in June 2010,¹² still pales in comparison to the United States at 17.09 percent and the European Union at more than 30 percent.¹³ Moreover, the augmentation is lower than the amount that was proposed at the G-20 Summit in September 2009, when increasing the voting rights share of developing countries was on the agenda.¹⁴

During the 2008 global financial crisis, the ASEAN+3 nations did not look to the IMF for help. On the one hand, this is due to the fact that the region was not hit as hard as it was during the 1997 Asian financial crisis. On the other hand, while the IMF remains dominated by developed nations—and the memory of the harsh conditions imposed upon them in 1997 remains vivid—the ASEAN+3 countries appear unwilling to turn to the organization for help unless absolutely necessary.

On the contrary, in response to the global economic downturn in 2008, the ASEAN+3 finance ministers met in Thailand in February 2009 and agreed upon an “Action Plan to Restore Economic and Financial Stability in the Asian Region,” which included developing the CMI into a regional foreign reserve pool.¹⁵ If the foreign reserve pool ever evolves into a fully mature regional financial mechanism, China, as well the other ASEAN+3 nations would be able to use it as a bargaining chip to jointly gain a stronger voice in the IMF. With a fully mature mechanism, if ever a financial crisis hits the region again, ASEAN+3 nations could refer to this regional pool for help rather than turning to the IMF. Under this scenario, if the IMF still wants to maintain its influence over East Asia, it would have to make certain concessions and grant ASEAN+3 nations a greater voice in the organization.

Undermining the IMF’s Role: Fact and Fiction

As noted above, the formation of the foreign reserve pool has raised concerns that it will undercut the IMF’s role as lender of last resort and weaken the influence of one of the pillars of the current international financial architecture. However, a number of issues should be considered before reaching conclusions about the likely impact of the foreign reserve pool on the IMF:

1. Governance Issues

The funds within the reserve pool will remain “self-managed” by individual countries, meaning that the reserves contributed by individual member countries will not be physically placed in a common fund but instead held individually within national central banks. Although the ASEAN+3 finance ministers agreed that a “regional surveillance mechanism for the CMIM should be further strengthened,”¹⁶ no further details or timetable for how this goal is to be achieved have been announced. Moreover, no announcement has been made on the establishment of a “super national” administrative mechanism that would presumably be needed to manage operation of the

12. Xu Yier, “ZhongGuo IMF Toupiaoquan Fen Er Yousuo Zengjia” [China’s Share of IMF Voting Rights Increased a Little Bit], *HeXun LiCai*, July 5, 2010, <http://money.hexun.com/2010-07-05/124146886.html>.

13. *Ibid.*

14. “G20 Agrees to Shift More IMF Voting Power to Developing Countries,” *Xinhua Wang*, September 26, 2009, http://news.xinhuanet.com/english/2009-09/26/content_12112800.htm.

15. Joint Media Statement from the Finance Ministers Conference in Phuket, Thailand (see footnote 4).

16. *Ibid.*

Table 1. Contribution and withdrawal rights under CMIM

Country	Contribution (\$ billion)	Share of total contributions (%)	Withdrawal rate (purchasing multiple)	Share of GDP (% of total)
Brunei	0.03	0.03	5	0.12
Cambodia	0.12	0.10	5	0.09
China ex.HK	34.2	28.50	0.5	36.41
HK	4.2	3.50	2.5	1.81
Indonesia	4.77	3.98	2.5	4.31
Japan	38.4	32.00	0.5	41.32
South Korea	19.2	16.00	1	7.82
Laos	0.03	0.03	5	0.05
Malaysia	4.77	3.98	2.5	1.86
Myanmar	0.06	0.05	5	0.22
Philippines	3.68	3.07	2.5	1.40
Singapore	4.77	3.98	2.5	1.53
Thailand	4.77	3.98	2.5	2.30
Vietnam	1	0.83	5	0.76
+3 (China, Japan and Korea)		80.00		87.36

Note: Each CMIM participant is entitled to swap its local currency with the US dollars for an amount up to its contribution multiplied purchasing multiplier. The last column indicates the proportion of the GDP (in US dollars, 2008) of the nation in the total GDP CMIM nations.

Source: Yonghyup Oh, "Lessons from the Asian Monetary Fund for the European Monetary Fund," CEPS Policy Brief 208 (April 2010), Center for European Policy Studies, http://aei.pitt.edu/14547/01/PB208_Yonghyup_Oh_EMF_and_AMF.pdf.

pool. As Zheng Liansheng, an analyst at China Securities Research, points out, as China and Japan are the largest contributors to the pool it is reasonable to assume they will become its “managing directors.” However, the problem of coordination between Beijing and Tokyo is “not only a technical problem but a political problem as well.”¹⁷ To manage the funds efficiently and respond to crises effectively, the ASEAN+3 countries need to consider establishing a secretariat. However, as Zheng also points out, this raises another set of potential problems: “China would propose Beijing, Shanghai or Hong Kong, Japan would favor Tokyo; South Korea would prefer Seoul and the ASEAN countries would suggest Singapore or Jakarta.”¹⁸

In May 2010, at the 13th ASEAN+3 finance ministers’ meeting in Tashkent, Uzbekistan, a small step was finally made on establishing a secretariat to “contribute to the effective decision-making of the CMIM.”¹⁹ Based on the joint media statement, the ASEAN+3 Macroeconomic Research Office (AMRO) will be located in Singapore “to monitor and analyze regional economies, which contributes to the early detection of risks, swift implementation of remedial actions, and effective decision-making of the CMIM.”

Although the statement adds that the “technical details” are still to be worked out, AMRO’s exact role and function remain ambiguous. Moreover, Chinese Finance Ministry official Zheng Xiaosong indicated that Beijing is disinterested in developing a rigorous surveillance mechanism, stating that “we should prevent it [AMRO] from intervening in other countries’ internal affairs, because the monitoring function is only a supervision or performance tracing mechanism necessary in order to provide consultation to relevant countries.”²⁰

However, according to the view of an economist from China’s Fudan University interviewed for this report, though the multilateralization of the Chiang Mai Initiative is widely considered a big step forward for East Asian regional monetary cooperation, the ability to respond effectively to a crisis might be weakened rather than strengthened because the cost and difficulty of a multilateral negotiation is always higher than a bilateral negotiation.²¹ He opines:

The announcements made so far by the ASEAN+3 countries are very ambiguous with respect to the governance of the fund. Even if the maximum amount of the fund participating countries are entitled to withdraw has been settled, the terms and conditions on the actual amount of funds participating countries can draw from the pool if ever a financial crisis hits again, are still vague. When the fund needs to be used in a real situation, the ASEAN+3 countries might need to come to the negotiating table altogether and it is unclear whether the decision would be made by a super-majority, a simple majority or unanimity. Therefore, the actual implementation of the CMIM might be much more difficult than the bilateral swap agreements.²²

17. Zheng Liansheng, “Dongya Waihui Chubeiku de Jinzhan Yu Weilai” (The Progress and Future of the East Asian Foreign Reserve Pool), *Zhongguo Caijing Bao*, May 12, 2009, http://www.cfen.cn/web/meyw/2009-05/12/content_517512.htm.

18. Ibid.

19. Joint Ministerial Statement from the 13th ASEAN+3 Finance Ministers’ Meeting in Tashkent, Uzbekistan (see footnote 5).

20. Joel Rathus, “Chiang Mai Initiative: Now in Singapore,” *Eris in Asia*, April 20, 2010, <http://eris-in-asia.blogspot.com/2010/04/chiang-mai-initiative-now-in-singapore.html>.

21. Telephone Interview with Chinese economist on October 6, 2010.

22. Ibid. Zheng Liansheng states that based on the contribution of participating countries, China and Japan individually account for 32 percent, South Korea 16 percent, and the ASEAN countries 20 percent. According to the IMF regulation, there should be an 85 percent approval rate to decide on “important affairs,” which means that the four major participants all have the veto right. See Zheng Liansheng, “Dongya

2. Political Commitment

Some of the major contributors to the reserve pool, including South Korea, Singapore, and Japan, appear to be seeking additional solutions to address the problem of Asian countries' short-term liquidity problems in the event of a crisis. For example, South Korea has proposed establishing a "global financial safety net" to broaden contingent financing on which countries could draw in case of trouble as well as establishing a global stabilization mechanism to create swap arrangements between regional mechanisms.²³

3. Technical Issues

Technically speaking, the foreign reserve pool is still not independent of the IMF. Under the agreement made in February 2009, 80 percent of the amount available would be disbursed only if the borrower also agreed to an IMF program though 20 percent would be disbursed immediately.²⁴ Conceived as such, the CMIM is largely a "second" or "parallel line of defense" to IMF financing.²⁵ Although the joint media statement finance ministers issued in February 2009 announced that, after the CMIM becomes fully effective, "the IMF de-linked portion may be increased above the current limit of 20 percent,"²⁶ it will still be difficult for the reserve pool to actually become more independent from the IMF due to: (1) the difficulty of establishing a surveillance mechanism, as stated above; and (2) based on previous opposition, resistance from the United States to expand the IMF de-linked portion.²⁷

Meanwhile, fully aware of the potential alienation of the ASEAN+3 countries from the IMF, the organization is now actively seeking ways to forge closer ties with countries in the region. In July 2010, in cooperation with the South Korean government, the IMF hosted a two-day conference in Daejeon. During the concluding press conference, Dominique Strauss-Kahn, president of the IMF, made three key commitments to Asia. The IMF will (1) work to make its analysis more useful and available to Asian members; (2) support the further strengthening of Asia's role and voice in the global economy; and (3) work to strengthen the global financial safety net. The IMF committed to work closely with Asia—through Korea's leadership on this issue in the G-20.²⁸

Waihui Chubeiku de Jinzhan Yu Weilai" (The Progress and Future of the East Asian Foreign Reserve Pool), *Zhongguo Caijing Bao*, May 12, 2009, http://www.cfen.cn/web/meyw/2009-05/12/content_517512.htm.

23. IMF Survey Online, "Asia and IMF Forge Stronger Partnership," July 13, 2010, <http://www.imf.org/external/pubs/ft/survey/so/2010/NEW071310B.htm>.

24. That is to say, agree to the IMF conditionality attached to the loans issued by the IMF.

25. Randall Henning, "The Future of the Chiang Mai Initiative: An Asian Monetary Fund?" *Policy Brief PB09-5*, Peterson Institute of International Economics, February 2009, <http://www.piie.com/publications/pb/pb09-5.pdf>.

26. *Ibid.*

27. At the peak of the 1997 financial crisis, when Japanese financial authorities proposed the creation of an Asian Monetary Fund to serve as a regional alternative to the IMF, the United States was strongly opposed, stating that it would undercut the IMF's role during a financial crisis. Therefore, during the CMI negotiation in 2000, the IMF link was a critical issue during negotiations over the framework. In 2001, the ASEAN+3 countries reached a compromise that 90 percent of the amount under the bilateral swap agreements under the CMI framework would be disbursed only if the borrower also agreed to an IMF program, and only 10 percent could be disbursed prior to such a program. In 2005, the finance ministers agreed to raise the IMF delinked portion to 20 percent. See Henning, "The Future of the Chiang Mai Initiative."

28. IMF Survey Online "Asia and IMF Forge Stronger Partnership," July 13, 2010, <http://www.imf.org/external/pubs/ft/survey/so/2010/NEW071310B.htm>.

During the conference, finance ministers from several Asian countries openly expressed their view that the Asian foreign reserve pool and other regional monetary mechanisms should serve as a supplement rather than a substitute to the IMF. Singapore's finance minister Tharman Shanmugaratnam said: "We are better off with both regional surveillance and IMF surveillance rather than one or the other."²⁹ Meanwhile, Haruhiko Koroda, president of the Asia Development Bank, also stated that he was impressed that "the IMF would strongly support regional financial safety nets like the Chiang Mai Mechanism" and opined that "the IMF has really changed and is now really on the side of the Asian countries to respond to these significant changes."³⁰

Given the significant obstacles facing the future evolution of the foreign reserve pool, it would be a mistake to conclude that it is likely to challenge the position of the IMF any time soon. Though the reserve pool has nominally speaking been put into operation, substantial ambiguity remains regarding how the fund will be governed and used, both routinely and during periods of crisis. As Randall Henning, a research fellow at the Peterson Institute for International Economics, argues, this ambiguity is in part "a consequence of a common desire to project solidarity to the rest of the world while substantial differences remain among the members, and it keeps options open and retains bargaining leverage for a better deal in international institutions."³¹

At the upcoming G-20 summits, if the United States and EU can agree to continue to increase the share of IMF voting rights among Asian developing countries—most notably China—and the IMF sticks to its commitments to continue working closely with Asian Countries, it is probable that the ASEAN+3 countries' desire to achieve further regional monetary cooperation will be weakened. Conversely, in the event of another regional financial crisis, if the IMF's response is weak or limited and there has been backtracking on the commitments made to give Asian countries a greater voice in the running of the global economy, then the ASEAN+3 nations are likely to set aside their differences and forge agreements on strengthening the function of the foreign reserve pool and other regional monetary cooperation mechanisms.

Looking Down the Road: What Is at Stake for the United States?

As noted earlier, there are some within the United States who view the multilateralization of the CMI with some trepidation, fearing that it will negatively impact U.S. interests and weaken U.S. influence in the region. Will it really "draw a line down the middle of the Pacific?" Some points to consider:

First, from an economic perspective, forming an "Asian bloc" that would effectively discriminate against U.S. interests would prove difficult. As noted by a professor from China's Fudan University interviewed for this report, in stark contrast to the G-8 member countries—developed nations with mature financial markets and who share common ground, can set binding regulations, and can achieve a win-win situation during negotiations—within the ASEAN+3 nations, economic conditions and financial markets vary tremendously. He opines: "Japan, South Korea, and Singapore now have relatively mature financial markets and could effectively hedge financial risks if ever a crisis hits again; China's financial market is still not well developed, but its US\$2.5

29. Ibid.

30. Ibid.

31. Henning, "The Future of the Chiang Mai Initiative."

trillion foreign reserves ensure that speculators would not first target it during any financial crisis”; meanwhile “the financial markets of Indonesia, Vietnam, Laos and Malaysia are still inchoate and very vulnerable to outside shocks.”³² In the event of another Asian financial crisis, it will fall on China, Japan, South Korea, and Singapore to rescue the other nations. This zero-sum game is “unsustainable in the long run and would prevent the ASEAN+3 nations from strengthening its monetary cooperation process and setting clear and binding regulations on how to use the fund in the reserve pool if ever a crisis hits again, since the 1997 crisis already demonstrates that within this region, analysts could never anticipate how severe the situation could be during a crisis period. The only viable alternative is therefore to let the regulations remain ambiguous and convene everybody at the negotiation table when something disastrous actually happens.”³³

Second, from a geopolitical perspective, it appears even more unlikely that member countries would want to form an “Asian bloc” that seeks to undermine U.S. influence in the region. Beneath the surface lies a deep-rooted strategic mistrust between and among the ASEAN+3 nations left over from history. Lingering Chinese and South Korean mistrust of Japan will make it difficult for them to share a leadership role in any regional monetary cooperation mechanisms, including the Asian foreign reserve pool. For example, as noted above, South Korea’s commitment to regional monetary cooperation mechanisms remains conditional. In contrast to his predecessor, Lee Myung-bak, on becoming South Korean president in 2008, began to pursue a more aggressive “Global Korea” agenda, broadening Seoul’s diplomatic scope beyond the Northeast Asian region. The new administration stated clearly that it would continue to support APEC (Asia Pacific Economic Cooperation), in which the United States is a member. Given tensions on the Korean Peninsula and Seoul’s ongoing security relationship with Washington, South Korea is unlikely to support any “Asian Bloc” aimed at excluding the United States.

Third, despite China’s diplomatic offensive, not all its neighbors have been charmed. Beijing’s rise as a regional and global power has aroused both economic and strategic fears to varying degrees among its ASEAN neighbors.³⁴ China’s rapidly increasing military budget and naval modernization are cause for concern—especially in view of the ongoing territorial dispute in the South China Sea over the resource-rich Spratly and Paracel islands.³⁵ Concern about China’s military ambitions has led neighboring ASEAN countries, particularly Vietnam, to try to “internationalize” the dispute. Comments by U.S. secretary of state Hillary Clinton, indicating that “the United States would be willing to facilitate multilateral talks on the issue,”³⁶ elicited a furious response from Beijing, charging that the United States was interfering in the issue.³⁷ Although in October 2010 Washington and Beijing softened their tone over the South China Sea dispute, the incident illustrates how long-standing tensions among the ASEAN+3 nations are likely to

32. Telephone Interview with Chinese economist on July 13, 2010.

33. Ibid.

34. Richard Sokolsky, Angel Rabasa, and C. Richard Neu, *The Role of Southeast Asia in U.S. Strategy toward China* (Santa Monica, Calif.: RAND Corporation, 2001), http://www.rand.org/pubs/monograph_reports/MR1170/MR1170.ch4.pdf.

35. Jiangyu Wang, “China’s Regional Trade Agreements: The Law, Geopolitics, and Impact on the Multilateral Trading System,” *Singapore Year Book of International Law and Contributors*, April 2004, <http://law.nus.edu.sg/sybil/downloads/current/jiang.pdf>.

36. “Offering to Aid Talks, U.S. Challenges China on Disputed Islands,” *New York Times*, July 23, 2010, http://www.nytimes.com/2010/07/24/world/asia/24diplo.html?_r=2&ref=world.

37. Ben Blanchard and Huang Yan, “China Tells U.S. to keep out of South China Sea Dispute,” Reuters, September 21, 2010, <http://www.reuters.com/article/idUSTRE68K1DB20100921>.

preclude the formation of an “Asian bloc” that would seek to undermine U.S. influence in the region.³⁸ Moreover, no amount of support for regional economic mechanisms will convince China’s neighbors of its peaceful intentions if at the same time it is viewed as seeking military expansion in the region.

Policy Recommendations for the United States

Although concerns initially appear overblown that forming the Asian foreign reserve pool is the first step toward an “Asian bloc” that will undercut U.S. interests and undermine U.S. influence in the region, Washington has no reason to remain complacent. The ASEAN+3 nations are moving inexorably closer toward regional monetary cooperation and are intent upon gaining a wider say in the operation of the international financial system. It is important for the United States to support this process and remain engaged so that the trans-Pacific partnership can move in parallel with Asian monetary cooperation. In practical terms, the U.S. government should consider the following:

- First, the Obama administration’s “smart power” approach to diplomacy with Southeast Asia needs to be pursued. Through proactive diplomacy and support for regional organizations, Washington needs to convince ASEAN nations that it is fully “reengaged” in the region. This diplomatic approach should be accompanied by a tangible trade and economic policy that builds on already strong economic ties with the region.
- Second, we fully support Randall Henning’s recommendation that the United States should articulate clear support for the CMIM initiative while underscoring the view that without a strong regional surveillance mechanism, support will be conditioned on the reserve pool’s continued linkage to the IMF as well as operational cooperation with the IMF.³⁹
- Third, the U.S. Federal Reserve should expand its swap facilities to the Central Banks of the ASEAN+3 nations. The United States has put in place large swap facilities with many central banks to help provide dollar liquidity to foreign financial institutions when those countries face short-term liquidity problems. The swap facilities are designed to improve liquidity conditions in global money markets by providing foreign central banks with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions.⁴⁰ These facilities include bilateral dollar-swap arrangements with Japan, Singapore, and South Korea and were important in responding to Korea’s difficulties during the 2008 global financial crisis. In May 2010, the U.S. Federal Open Market Committee authorized reestablishment of its temporary U.S. dollar liquidity swap arrangement with the Bank of Japan, through January 2011.⁴¹ If the ASEAN+3 nations could ensure some guaranteed back-up from the United States to solve their short-term liquidity problems during any upcoming crisis, their desire to barricade themselves behind a wall of Asian solidarity would probably wane accordingly.

38. “U.S. and China Soften Tone over Disputed Seas,” *New York Times*, October 12, 2010, <http://www.nytimes.com/2010/10/13/world/asia/13gates.html>.

39. Henning, “The Future of the Chiang Mai Initiative.”

40. Federal Reserve Bank of New York, “Central Bank Liquidity Swaps,” http://www.newyorkfed.org/markets/liquidity_swap.html.

41. Board of Governors of the Federal Reserve System, “Press Release,” May 10, 2010, <http://www.federalreserve.gov/newsevents/press/monetary/20100510a.htm>.

- Finally, Congress should ratify the Korea-U.S. Free Trade Agreement (FTA). The FTA was signed on June 30, 2007, but is still pending congressional Approval.⁴² Ratification of the FTA will further embrace South Korea within the U.S. sphere economically and be further proof of U.S. engagement and commitment to the region.

42. Office of the United States Trade Representative, “Korea-US Free Trade Agreement—Pending Congressional Approval,” <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta>.



ABOUT THE AUTHORS

Wen Jin Yuan is a researcher with the Freeman Chair in China Studies at CSIS, where she specializes in China's economic and financial issues as well as economic integration in East Asia. She is the coauthor of *Is China Ready to Challenge the Dollar?* (CSIS, 2009) and is also a special contributor to Knowledge@Wharton, the online journal of the Wharton School, University of Pennsylvania. During her undergraduate studies, Ms. Yuan worked as a research assistant for several professors at the School of Economics, Fudan University, focusing on China's economic development issues. Ms. Yuan, who is from China, received a BA in economics from Fudan University and an MPP from the School of Public Policy, University of Maryland, College Park. She is currently a PhD student in policy studies at the University of Maryland, concentrating on international security and economic policy.

Melissa Murphy is a fellow with the Freeman Chair in China Studies at CSIS, where she works on issues related to China's domestic political and socioeconomic developments. Prior to joining CSIS, she was a China specialist with the international law firm Dewey Ballantine, focusing on U.S.-China economic and trade relations and China's legal and regulatory developments. Before attending graduate school, she spent seven years in Hong Kong and Okinawa, Japan, working for the U.S. government to monitor political and economic developments in East Asia. She is the author of *Decoding Chinese Politics: Intellectual Debates and Why They Matter* (CSIS, 2008) and coauthor of *Is China Ready to Challenge the Dollar?* (CSIS, 2009) and *Soft Power with Chinese Characteristics: The Ongoing Debate* (CSIS, 2009). Among her other publications, she is also a contributing author to the book *China's Rise: Challenges and Opportunities* (Peterson Institute–CSIS, 2008). Ms. Murphy, who is from the United Kingdom, received a BA and an MA with honors from Cambridge University. She graduated from Harvard University with an MA in East Asian studies, concentrating on China's political and economic transformation.

1800 K Street, NW | Washington, DC 20006

Tel: (202) 887-0200 | Fax: (202) 775-3199

E-mail: books@csis.org | Web: www.csis.org

