AN ASIAN RESPONSE TO THE ASIAN CRISIS: THE PROPOSAL FOR AN ASIAN MONETARY FUND

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The Asian financial crisis of 1997-1998 was followed by a flurry of reform for prudential regulation. The financial press has generally represented this as an adequate response to the meltdown of 1997-1998. However, recent moves towards financial integration in Asia recognise that the destabilising factors endemic within financial markets need to be addressed, and not just weaknesses of existing institutions. Asian governments are also realising that a regional arrangement may be more appropriate than existing international structures. For future crises to be averted, new institutions may be required.

Is there a case for an Asian Monetary Fund (AMF)? In this article I will argue that the basis of the IMF's role during the Asian crisis warrants the creation of an AMF. In particular, the high risk of illiquidity in Asian financial systems requires an adequately resourced credit facility for the immediate provision of funds, to pre-empt currency runs and restore market confidence. While the movement for a new 'international financial architecture' stalls, cooperative steps being taken in the region suggest that the creation of an AMF is the most promising and likely initiative to pre-empt future crises.

Understanding the Asian Crisis

The story of the Asian crisis is now familiar. In the 1990s, eager to lend and eager to borrow, banks and financial companies swamped the economies of East Asia with cheap and increasingly short-term funds resulting in a surge in domestic credit which in turn fuelled a bubble, most notably in the Thai real estate sector. As the bubble grew, so too did the economy's fragility as it became further exposed to changing international sentiment. Thai banks borrowing short and lending long created severe maturity mismatches alongside an already increasing external debt. As a result, speculative attacks against the Thai baht became more frequent. After spending almost all of its $30 billion in reserves defending the baht, the Bank of Thailand finally conceded defeat and floated the currency on 2 July 1997 (Montes 2001: 97). Within months other currencies around the region followed, and the Asian crisis was born. A region that had been labelled as an 'economic miracle' was suddenly portrayed as a haven for reckless investors, opaque and insolvent institutions, highly leveraged corporations, corrupt governments and crony capitalism (Park 2001: 1).

The intensity of the crisis was matched by the intensity of debate about the reasons for it. Although explanations abound, two principal aproaches can be identified[1]. On the one hand, the 'orthodox' approach contends that the crisis resulted from institutional and structural weaknesses of the Asian economies, such as 'cronyistic' political and economic structures and misguided government policies. On the other hand, the 'failure of international financial markets' theory argues that the crisis is characteristic of under-regulated and over-liquid international financial markets (Chang, *et al.* 1998: 649).

In explaining the excessive nature of capital flows, the orthodox approach stresses rational calculations – at least in the short-term – responding to market distortions and institutional weaknesses. In essence, four deficiencies have been identified as having together led to crisis. First, a lack of transparency in company (borrower) and bank accounts inhibited investors' knowing the true position of borrowers. Second, weak prudential regulation allowed banks to lend to heavily indebted companies, resulting in a rapid build up in non-performing loans. Third, poor exchange rate management - that is a commitment to

1 A division along these lines has been made by a number of prominent theorists. See Chang *et al.* (1998), Wade and Veneroso (1998), and Wade (2000).

fixed exchange - took the private risk out of foreign borrowing. As a corollary, moral hazard existed as investors expected that banks and firms would be bailed-out by Asian governments (Wade 2000: 89). These attributes were characteristic of, and facilitated by a system of 'crony capitalism'. As the World Bank stated in its 1998 report *East Asia: the Road to Recovery*,

> Rising global liquidity fed huge amounts of capital into the poorly regulated institutional setting with limited transparency, and related party lending, often with negligible due diligence from foreign lenders. Implicit and explicit government guarantees on the exchange rate and selected investments fed into a domestic credit boom that macroeconomic policy failed to manage (p 9).

The first problem with this orthodox explanation is that it is one-sided: it identifies these characteristics as the reason for crisis, while almost entirely ignoring the possibility of shortcomings among international financial suppliers. It is true that many, if not all, East Asian economies exhibited these features. In Thailand the rules governing banks had specifically sought to allow banks to lend to highly geared corporations. In fact, this was a critical aspect which enabled high rates of domestic savings to be channelled into equally high levels of investment. A lack of transparency and monitoring was also characteristic of Thailand. Banks at the centre of Sino-Thai conglomerates lent to their own trading corporations, the strong ties between banks and firms circumventing the need for transparency and strict monitoring. On the other hand, where the orthodox explanation rejects these arrangements as crony capitalism, their intent is to provide a secure and stable platform for development and growth, which until recently has been spectacularly successful. 'Crony capitalism' is but a by-product of these arrangements and not their basis (Johnson 1998: 655). As Pasuk and Baker argue about Thailand,

> Inadequate institutions, corrupt politicians, and imperfect liberalisation. All these factors were certainly there. But they had 'always been there'. ...[this] explanation of the bust glossed over the erratic nature of the financial flows (1998: 318, their emphasis).

The alternative explanation focuses on financial liberalisation and international financial markets. This explanation represents the Asian crisis as but one of a series of financial crises, that 'tend to be associated with an open capital account and large foreign capital inflows, producing a credit bubble which sometimes ends in crisis' (Wade 2000: 87-88). The Asian crisis, like the Mexican, Irish, and Russian financial crises of the 1980s and 1990s, is evidence that over-lending and over-borrowing are endemic market failures of over-liquid and under-regulated financial markets (Palma 1998: 789). The infamous international financier George Soros went as far as to state that 'financial markets have recently acted more like a wrecking ball, knocking over one economy after another' (1998:p. xvi). In short, the problem lies in international financial markets and not Asian economies.

The surge in world liquidity in the 1980s and 1990s precipitated the propensity to over-lend. Reflecting the exponential growth in the ratio of financial stocks to world GDP and the development of new financial instruments[2], the world's central bank reserves rose by well over 200% between 1982 and 1986 (Wade 2000: 100). The consequent competitive pressure to recycle funds impaired investors' capacity to assess and price risks and to allocate funds effectively. As Palma argues, 'they inexorably move to the other extreme, from lending to those who do not need to borrow to those who will not be able to pay' (1998: 791).

The problem is that in time an unholy alliance is formed between lenders and borrowers. First, the competitive pressure on banks prevents them from sitting tight on their ballooning liquidity. The insatiable need to earn interest on funds available impels banks to lend to increasingly questionable borrowers. A bank that does not earn profits where others do is viewed as incompetent, but if it suffers losses as everyone else does, no real harm is done. Second, as firms see others making profits from speculative investments they tend to follow, 'monkey see monkey

2 However, the roots of the increase were in the US, where fiscal and current account deficits were financed by inflows largely in the form of foreign purchases of US government debt. Moreover, the surplus countries accumulation of US assets especially Treasury bonds, inevitably led the banks in these countries to increase their lending providing the foundation for a surge in world liquidity (Wade 2000, pp. 99-100).

do' (Kindleberger 2000: 15). As a result the number of firms engaging in these practices increases as behaviour moves away from reality and borrowers seeing what others are doing join the herd. Banks impelled to lend have no choice but to invest in the fairytales of borrowers, hence conveying the view that they do not want the truth about likely investment returns. In short, the propensity to over-lend based on unreal expectations, or what Stiglitz refers to as 'excessive exuberance', fuels expectations and entices further demand for borrowing (2002: 198). The sudden increase in liquidity and lending precipitates further exuberance and creates a self-fulfilling prophecy whereby supply creates demand (Palma 1998: 792-293). These two major failings of financial markets are exacerbated in an under-regulated climate, as was the case with the recently opened capital accounts of nations like Thailand.

This explanation of the Asian crisis stands in stark contrast to the 'crony capitalist' thesis. It stresses the endemic failings of financial markets and the cumulative irrationality of market participants, as opposed to the belief in rational calculations responding to market distortions and institutional weaknesses. Given its theme, 'the failure of international financial markets' theory points to the need for reform that recognises the true nature of financial markets. This becomes more important given the IMF's unwillingness to provide funds at the beginning of the currency runs, reflecting the orthodox view that institutional weaknesses of East Asian economies were solely to blame. The question then becomes 'reform at what level?'

Regional versus International Reform and Thailand's Bank-Based Financial System

While it is argued that the growing dominance of financial capital needs to be contained at the international level, for East Asia, a strong case for regional institutions can be made. Despite an initial surge of proposals for a new 'international financial architecture', reform has been piecemeal and progress has stagnated. In contrast, cooperation in Asia has increased and substantive progress has been made. For example, the Chiang Mai Initiative in 2000 has led to a series of bilateral swap arrangements being established in East Asia to assist countries facing the probability of a liquidity shortfall (Li Lin and Rajan 2001). In any case, international institutions such as the IMF have shown little desire for change. The IMF has renewed its intention to add capital account liberalisation to its charter (IMF 1998).

More importantly, a common appreciation of the nature of East Asian economies suggests that regional arrangements such as an AMF could more effectively manage the threat of currency runs and resultant liquidity shortfalls, than current international arrangements. Many Asian financial systems – particularly in East Asia – have been largely bank-based and must be insulated from the destabilising effects of international financial markets. A common appreciation of this need was a key reason behind the Japanese proposal for an AMF. As Deputy Finance Minister Mr Sakakibara argues, the US-IMF push for a shift from bank lending to equity-based financial systems may not be appropriate for developing countries following a different development path[3]. Hamilton-Hart also argues that a better understanding of the needs of East Asian economies would make regional arrangements preferable to international ones (2003: 291).

The Thai financial system provides a case in point. The rise of Thailand to the rank of 'miracle' economy was largely premised on a bank-based financial system. In essence, a bank-based financial system is a closely regulated system where banks, rather than capital markets, are the central financial entities. Central to such a system is the insulation of commercial banks and a highly geared corporate sector, enabling high rates of domestic savings to be channelled by commercial banks into correspondingly high levels of investment. The nature of this financial system ensures a constant risk of illiquidity. Highly geared firms inevitably face liquidity shortfalls and banks which carry the loans of firms, in turn, face the constant threat of instability.

In Thailand, the risk of illiquidity was managed first through targeted prudential rules. Reserve requirements stating that, commercial banks for example, hold 16% of the bank's deposits in government bonds coupled

3 Mr Sakakibara was highly critical of the 'Washington Consensus' approach, insisting that an AMF would be an appropriate mechanism with which to cater to the needs of East Asian economies. See Altbach (1997).

with strict definitions regarding cash reserves were administered by the Bank of Thailand (BOT). Similarly, interest rate ceilings such as on fixed one-year deposit rates were used to keep domestic rates in line with foreign rates to alleviate liquidity problems or, to administer monetary policy (Warr and Bhanupong 1996: 40). Secondly, the BOT acted as a lender of last resort to firms and banks that suffered temporary liquidity shortages. On a day to day basis, the BOT managed the risk of illiquidity by socialising it in part by extending credit to banks through the purchase of promissory notes, and the banks in turn could extend credit to businesses in key growth sectors through the use of a novel feature called the 'rediscount window'. The rediscount window allowed commercial banks to charge higher interest rates for the purchase of promissory notes from key sectors than the original rate the BOT had charged them. This encouraged commercial banks that did not want to absorb all the credits granted by the central bank to pass these credits onto significant economic sectors. As the central bank explains,

> [a]ssuming the BOT charges commercial banks an interest rate of 5 percent per year, commercial banks are allowed to charge 7 percent for the purchase of the promissory notes from farmers or other businesses under the Government's support program. This is equivalent to extending low-interest loans indirectly to the private sector (1992: 160).

In addition, when individual large commercial banks faced severe liquidity shortfalls – as in 1959, 1960, 1979, and 1984 – the BOT mobilised deposits of other commercial banks to address the immediate liquidity problems. The central bank also organised a new management team to take over the operation of any bank that was a beneficiary of this scheme (Warr and Bhanupong 1996: 41). This style of rescue was formalised in 1985 with the creation of the Financial Institutions Development Fund.

The liberalisation of prudential rules and the opening of the capital account in the early 1990s destroyed the pre-existing Thai financial system, and the buffer it provided against the risk of illiquidity. The opening of the capital account allowed Thai commercial banks to significantly advance their participation in international financial markets. Between 1993 and 1997, foreign liabilities of Thai banks jumped from 350 billion baht to 1,900 billion baht (Siamwalla *et al.* 1999: 31). Then, as foreign lenders later rushed to call in their loans, Thai firms and commercial banks faced serious liquidity shortfalls. The amount of funds required swamped the old mechanisms for managing liquidity shortages. The exposure of the bank-based financial system in Thailand to the destabilising factors endemic within financial markets precipitated a crisis of liquidity. The inability to address the huge liquidity shortfalls transformed a crisis of liquidity into one of insolvency. This problem was not helped by the intervention of the IMF, which called for temporarily illiquid firms and banks to be closed.

It is argued, particularly by the IMF, that part of the problem lies in the capital structure of Asian financial markets. Bank-based financial systems, it is claimed, lead to inefficient allocation of resources and increased risk by not allowing diversity in the sources of funding. One answer then is better bond markets to increase diversity and lengthen the tenure of debt. A recent study by Eichengreen (2004) shows that the emphasis on developing Asian bond markets is misplaced. Asia relies less on bond markets than other emerging economies and comparatively theirs are well developed. Eichengreen (2004: 10-11) argues that '[a]dvocates of this conventional wisdom must come to grips with the fact that Asian countries grew admirably for many years despite the dominance of banks and the underdevelopment of their bond markets' and that crises have not recurred in the region despite the persistence of such features. While improving Asian bond markets is certainly beneficial, and indeed the process has already begun under APEC and ASEAN+3, these debates should not deflect attention from the need for a regional institution that will hem in the destabilising factors endemic within financial markets.

The IMF or an AMF?

The failure of the IMF to intervene in the lead up to July 1997, and hence pre-empt the currency runs, reflected a fundamentally flawed conception of financial markets and the economies of East Asia. Financial markets exhibit patterns of excessive exuberance and herd-like behaviour, which can quickly precipitate a run on banks, fuelling a crisis of liquidity. This is particularly dangerous in the context of bank-based financial systems and high debt to equity corporate sectors with open capital accounts. In this environment how is the risk of illiquidity to be managed? First and foremost, the Asian crisis illustrated that an adequately financed facility for the immediate provision of funds must be available to pre-empt currency runs and restore market confidence. Second, this requires adequate surveillance and monitoring on a continual basis to evaluate the necessity of emergency credit provisions. Third, the ability to pre-empt currency runs and restore market confidence necessitates a full appreciation of the problem of contagion, which in part is a result of the informational asymmetries and herd-like behaviour of financial agents.

It is argued by many, including those at the Fund, that the IMF can adequately fulfil these roles. Former IMF Deputy Managing Director Stanley Fischer asserts that the temporary availability of the IMF's resources to members in need, under the appropriate safeguards, enables countries 'to take actions to stem the destructive effects of an external crisis' (1997). However, an analysis of the IMF's role during the crisis suggests that it was precisely the failure to provide funds to pre-empt currency runs and restore confidence, coupled with insufficient monitoring of the situation and an underestimation of the problem of contagion, that necessitates change. But establishing the failings of the IMF does not logically warrant the creation of an AMF. For an AMF to be warranted it must overcome the deficiencies of the IMF.

First, the unwillingness of the IMF to provide funds to East Asian governments to forestall currency runs and restore market confidence reflects the IMF's adherence to the orthodox explanation that the crisis was the result of the institutional weaknesses of East Asian economies. However, 'the failure of international financial markets' theory demonstrates the naiveté of this stance. The volatility of financial markets characterised by the tendency of investors to display herd-like behaviour is particularly hazardous in over-liquid and under-regulated markets. In the economies of East Asia where this was the case, the immediate goal - as Wade and Veneroso (1998: 5) argue - 'must be to restore confidence'. However, rather than providing a quick disbursal of funds to restore confidence, the IMF vehemently criticised East Asian economies for 'crony capitalism', exacerbating the capital stampede out of East Asia (Stiglitz 2002: 97).

Second, the issue of monitoring and surveillance in Asia has been particularly pronounced in the aftermath of a crisis so unexpected. Despite claims by the IMF that it warned of an 'impending crisis'[4], the actual reports of the IMF suggest otherwise. Sachs notes that when the IMF arrived in Thailand in July 1997,

> With the ostentatious declarations that all was wrong... the ink was not even dry on the IMF's 1997 annual report, which gave Thailand and its neighbors high marks for economic management (cited in Bullard *et al.* 1998: 87).

The failure of the IMF to extrapolate from the evidence is clear. As East Asian governments liberalised their financial systems, foreign capital flooded in. Private inflows to Korea, Thailand, Malaysia, Indonesia, and the Philippines amounted to US$40 billion in 1994 and over US$100 billion in 1996 (Wade 2000: 17). The huge capital inflow became a problem as businesses started to depend on short-term borrowing for long-term investments, especially in the real estate market. The persistence of this process resulted in a rapid build up in non-performing loans as local real estate markets faltered (Altbach 1997: 3). In Thailand for example, 30% of loans were non-performing (Bird and Rajan 2002: 11). By July 1997, nervous investors took their capital and fled through the open capital account. The failure of the IMF to provide any forewarning represents a glaring deficiency in monitoring and surveillance.

Finally, the neglect by the IMF of contagion - the simultaneous occurrence of currency crises in two or more economies - is evident in its actions (Li Lin and Rajan 2001: 103). The desire by the IMF not to provide a quick disbursement of funds in the lead-up to the crisis, coupled with the labelling of the entire region as 'crony capitalist', fuelled the 'transmission channels' of contagion. Li Lin and Rajan argue that two principal 'transmission channels' of contagion are based on the

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4 This claim comes from Thomas Dawson, Director of External Relations for the IMF, in a speech made in July 2002.

generalised sentiment of investors. First, losses in one economy may lead mutual funds or banks to liquidate positions in other regional economies in which they are exposed. Second, extra-regional investors tend to lump emerging market economies into sub-regions rather than making country-specific evaluations (2001: 11). Accordingly, the tag of 'crony capitalism' and the failure of the IMF to restore market confidence fuelled contagion.

The threefold failings of the IMF identified here inevitably lead to the question of whether the creation of an AMF would overcome these deficiencies, that is, is it warranted? Bird and Rajan argue that in order to make the case for an AMF, 'there has to be a reasonable presumption that an AMF could undertake a necessary function more efficiently than the IMF' (2000: 142-143). Accordingly, I will argue that the three fronts on which the IMF failed are precisely those where an AMF would succeed. Before this claim is developed though, a brief outline of the proposal is necessary.

In September 1997, Japan proposed an AMF with a mobilising capacity of an estimated US$100 billion which could quickly disburse funds to members or institutions in the region, without the cumbersome decision making procedures that plague the IMF. The potential speed of the response would restore confidence and reduce regional contagion (Altbach 1997: 9). The proposal for a regional monetary fund reflected dissatisfaction with the IMF's handling of the crisis. The dissatisfaction included claims that the IMF failed to foresee any likelihood of crisis, and when the crisis hit, its misdiagnosis destroyed market confidence and precipitated contagion. Adopting the suggestion of Bird and Rajan, the case for an AMF can be made by addressing the three areas where the IMF failed; fund disbursement, monitoring and surveillance, and contagion.

Arguably, the most important reason for an AMF is the early provision of sufficient funds to pre-empt crisis and maintain market confidence. The advantage of an AMF is that it could build upon the high savings of a region where government foreign exchange reserves for the 'ASEAN plus three' nations (Japan, China, and Korea) are now in excess of $2.1 trillion, up from $715 billion in 1996 (de Brouwer 2004: 5). By holding, or being able to mobilise a pool of resources built on these reserves an

AMF would have sufficiently large credit lines to provide more predictable support for countries in crisis. As de Brouwer states,

> With this sort of armoury, it is hard to see how the region would be exposed to a play of events similar to that which occurred from mid 1997 to late 1998 (2004: 5).

Moreover, Mathews and Weiss (1999) argue that the establishment of an AMF would improve the credit worthiness of Asian borrowers in international capital markets, 'because it would signal the region's financial soundness and maturity'. An AMF would have the capacity and credibility to intervene in Asian stock and bond markets, much like the Hong Kong Monetary Authority did in 1998. In addition, Altbach points out that an AMF 'would not be bound by the IMF's limits on the size of a bailout based on the recipient's quota'[5] (1997: 9), although, an AMF would likely control the size of a bailout according to the strategic importance of an economy to the region. Even proponents of the IMF note its relatively scarce financial resources and the limits therein (Knight *et al.* 2004)

Not only would the funds be available, but their provision would be quick and flexible. The key is the timing and type of conditionality attached. Whereas the IMF requires member countries to implement strict conditionalities just for the right of access to funds, an AMF would not make up-front conditionality a prerequisite for initial credit. What was significant about the Japanese proposal is that it would be lightly conditional, so that as soon as the first signs of distress became obvious, the funds would be available to help a member country replenish reserves (Wade 1998: 702). Further, a prospective borrower would not be forced to come cap in hand to initiate help. The decision to provide funds would be made jointly through a regional surveillance mechanism such as the ASEAN Surveillance Process (ASP), where central bankers and regionally experts together assessed the need for fund disbursement, as we will see later (Manupipatpong 2002: 113). The mutual participation

5 The IMF sets an upper ceiling on rescue packages of four or five times a member's quota. This rule was temporarily abandoned for Korea's bailout during the crisis.

and vested interests should provide strong incentives to make the system work and thereby guard against abuse.

But an AMF would not be a slush fund. Conditionality would apply, but not up-front, and not in the form of preconceived structural adjustments. With a better appreciation of East Asian economies given its geographical proximity, an AMF could design more appropriate conditionality. That is, conditionality that deals with a crisis of liquidity and therefore does not impose structural adjustment requirements that increase the risk of insolvency and in turn undermines the long-term development of East Asian nations. However, would AMF conditionality, like IMF conditionality, be constrained by its need to ensure adequate returns on international capital investment? An implicit, but fundamental role of the Fund is to enforce returns on as much of their investments as possible. It can be assumed that an AMF would also be bound to ensure adequate returns for AMF fund providers. The crucial difference with an AMF, however, would be its better appreciation of bank-based financial systems. Unlike the IMF, an AMF would realise that the best way to guarantee returns in the long run is to sustain temporarily illiquid banks and firms with bridging loans rather than imposing structural adjustment. For example, more appropriate conditionality would not insist on the repayment of hard currency loans ahead of any concern for future development. But an AMF could require members to meet financial benchmarks appropriate to bank-based financial systems, and or, to introduce interest rate incentives for the quick repayment of loans. Such conditionality would more readily ensure returns, as far as possible, on the investments of AMF fund providers. This was recognised by Japan in late 1997 when South Korea was on the verge of default. Although the sum of funds proved inadequate, Japanese authorities provided bridging loans while endeavouring to persuade private bankers to maintain their credit lines with South Korea (Tadokoro 2003: 226).

The willingness of an AMF to provide funds quickly and flexibly would allow Asian governments and companies to re-finance their western loans and provide selective new loans for recovery programs, in other words to manage the risk of illiquidity. The delay and inflexibility of liquidity provisions was exactly what the IMF was vehemently criticised for. It is argued that the slowness of the provision escalated the crisis from one of liquidity to one of solvency. In part, this was a result of the cumbersome decision-making procedures involving conditionality, which ensured the provision of funds became a drawn-out process. In response to criticism that the protracted nature of IMF loan disbursal worsened the crisis, the IMF created the Contingent Credit Line (CCL) in 1998. The idea was to establish a precautionary line of credit for those countries that might be affected by contagion. However, as Bird and Rajan point out, its weaknesses, namely the relatively high cost of borrowing from it, have been widely recognised and as yet no country has negotiated a CCL (2002: 41-42).

The preparedness of an AMF to provide funds however could create a moral hazard. Giannini claims that geographical proximity may increase awareness of the cost of inaction to the point of making a regional institution like an AMF overemphasise the need for financing (1999: 43). Although the problem of moral hazard could exist, the chance of an AMF overemphasising the need for funds is unlikely. Bird and Rajan argue that any lender of last resort faces a moral hazard problem, but the very idea behind an institution such as an AMF is that the maintenance of confidence is seen as more important (2000: 139). Accordingly, insulation against the risk of illiquidity requires more than an available pool of funds: it also involves a quick and flexible disbursement based on an understanding of the needs of East Asian economies. However, doing so necessitates adequate surveillance and monitoring and an appreciation of the problem of contagion.

The original proposal for an AMF envisaged its taking over the regional surveillance activities of the IMF. In the event, the collapse of the proposal precipitated the creation of a diluted 'Manila framework', which focussed on the desire to enhance regional surveillance. It called for a mechanism for regional surveillance that built on the ASP, where a peer review of each other's economic and financial situation is undertaken on a regular basis. To coordinate the ASP, the ASEAN Surveillance Coordinating Unit (ASCU) was created at the ASEAN level, and in each of the 10 member economies to monitor global economic and financial developments, and to coordinate all surveillance activities, including preparing half-yearly ASEAN Surveillance Reports

(Manupipatpong 2002: 112). The advantage of the ASP framework is that its surveillance network comprises regional experts and ASCU staff familiar with the region. This should enable a better appreciation of the impact that developments in financial markets are likely to have on East Asian economies, particularly about the risk of illiquidity in bank-based financial systems. Wang argues that the benefit of such an initiative would be that:

> [s]urveillance committees [could] conduct the job of monitoring on a continuous basis and evaluate the necessity of emergency credit provision (2000: 205).

Moreover, the increasing number of bilateral swap arrangements (BSA) in the region, as we will see later, has meant that coordination between countries to monitor closely economic and financial developments is more likely, and also more effective, given the mutual incentives to better appreciate the liquidity needs of countries that request an activation of the BSAs (Manupipatpong 2002: 116).

Finally, improved surveillance and monitoring must be matched with an appreciation of the problem of contagion if funds are to be disbursed in a timely manner to pre-empt currency runs and restore confidence. The collapse of the baht on the 2nd July 1997, followed by the ringgit on the 14th, the rupiah on the 14th of August, and the won on the 16th of December, demonstrated the extent of contagion. (Wang 2000: 205). The generalised sentiment of investors which fuelled negative spillovers throughout the region was worsened by the IMF's inability to restore confidence. An AMF which would undertake comprehensive surveillance and monitoring by regional experts, who would acknowledge the instabilities of financial markets and recognise the need for bank-based financial systems to be insulated from the risk of illiquidity, would be in a better position to prevent the spread of crisis with the timely disbursement of funds.

Accordingly, an AMF would be superior to the IMF. First, the freedom from IMF quota constraints would ensure that credit lines would be sufficient to pre-empt currency runs and restore market confidence. Second, conditionality would be less stringent, more appropriate, and flexible. Third, better local knowledge and an appreciation of the need to manage risk in bank-based financial systems would ensure that the provision of funds is timely to insulate against the risk of illiquidity. Fourth, an AMF would be free from IMF intellectual baggage rooted in neoclassical theories of market behaviour. Intellectual freedom would enable the formation of arrangements that appreciate the need for factors endemic within financial markets to be hemmed in.

Is the Creation of an AMF Likely?

Since the US and the IMF quashed the Japanese proposal for an AMF in 1997, several cooperative steps have been taken, principally the establishment of the Manila framework, the Miyazawa Initiative, and the Chiang Mai Initiative (CMI). The likelihood of an AMF evolving from such initiatives rests on the geo-political tensions that permeate the notion of an AMF.

The abortive exercise, led by Japan in 1997, to set up an AMF demonstrates the geo-political tensions, particularly between Japanese and US interests. The Japanese proposal reflected the deepening commitment of Japan to Asia, and importantly the extent of Japanese economic exposure in the region. Altbach (1997: 5) points out, that the immediate incentive for Japan to aggressively respond to the spreading currency crisis was the exposure of Japanese banks. In 1996, Japanese banks had $83.9 billion in outstanding loans to Thailand, South Korea and Indonesia alone, and $265 billion at risk in Asia as a whole. The AMF proposal also reflected a Japanese desire to try its hand at long-promised but never delivered international leadership (Johnson 1998: 658). However, the initiative met with fierce resistance from the US and IMF, who correctly sensed that their interests might be threatened. IMF Managing Director Camdessus and his deputy Fischer both chastised the proposal as a potential threat to the effectiveness of the IMF. Without the leverage of being the only source of assistance, the IMF feared its ability to get crisis-hit countries to agree to reforms would be undermined (cited in Altbach 1997: 10).

Moreover, if the Japanese had succeeded they would have been endowed with a greater autonomy to begin sending their surplus capital to Asia instead of the world's number one debtor nation, the US. The Americans could not let this happen. If the US is to avoid a debt deflation crisis, Japan's surpluses must be recycled into the American financial system. At the time of the crisis, 80% of Asia's $600 billion foreign exchange reserves were invested in North America and Europe (Hamilton-Hart 2003: 292). In addition, the huge balance of payment surpluses and foreign exchange reserves of other East Asian countries, notably China, Hong Kong and Singapore, were largely invested in US Treasuries. In 1997 for example, the Hong Kong central bank held about $60 billion of its foreign exchange reserves in US securities (Nordhaug 2000). With an AMF, there would be a much greater incentive for the central banks of East Asia to invest in stabilising the financial systems in their region.

The potential economic and security threat that an AMF could pose to US interests is illustrated in former US Treasury official Fred Bergsten's testimony before the United States House of Representatives in 1997:

> Japan's proposals for an Asia-only 'Asian monetary fund', which would exclude us from the most crucial area of cooperation with (what are still) the world's most dynamic economies (as well as the largest sources of security problems). The costs of any such outcome, to the broad national security as well as economic interests of the United States, would play out over many years and could be huge.

Higgot succinctly articulates the reasoning behind the US' categorical rejection of the AMF proposal:

> US policy towards an incipient AMF reflects a private-sector desire for continued financial liberalisation on one hand, and, on the other, *[a political]* desire not to cede the power of international financial institutions... to regional institutions over which they would certainly have less ideological/philosophical and practical control (Higgot 2000: 258).

Can an AMF be created in the face of US opposition? The strength of US opposition raises doubt that an AMF will be established. However, several steps have been taken that point to renewed cooperation within the region and the desire for an AMF. More importantly, these steps reflect a growing Asian constituency born out of resentment with the US-

IMF handling of the crisis, that if cultivated, will provide the momentum for regional cooperation.

Initial moves began in 1998 with the establishment of the Manila framework and the Miyazawa Initiative. The Manila framework, as noted, sought to restore financial stability in the region through enhanced regional surveillance and economic and technical cooperation (Wang 2000: 205). Similarly, the Japanese Miyazawa Initiative (named after a former Japanese finance minister) aimed at supporting the crisis-affected Asian countries and insulating their banks from the risk of illiquidity and thus, of course, the Japanese lenders to the region. The $30 billion initiative provides funds both directly and through a special facility[6] established in the Asian Development Bank (ADB) to guarantee sovereign bonds issued by East Asian states. These bonds are then used to recapitalise ailing banks and corporations in the region (Hook *et al.* 2002: 185). However, the crucial point here is not just the immediate significance of these initiatives. Rather, it is to suggest, as Higgot points out, that it would be naive to ignore the prospect that Asians will introduce greater regional institutional mechanisms (2000a: 257).

More significantly, the CMI agreed to in 2000 aims at providing additional short-term advances of hard currencies to countries facing the threat of liquidity shortfalls. Through a network of BSAs and repurchase agreements, the desire is to establish a "firewall" against future financial crises (Li Lin and Rajan 2001: 103). The BSAs are in the form of swaps of US dollars with domestic currencies, where the amounts that can be drawn are determined by bilateral negotiations. Since the ASEAN+3 meeting in November 2000, Japan has been very active in negotiating BSAs. It has concluded negotiations with Thailand for $3 billion, Korea $2 billion, and Malaysia $1 billion, and is in the process of negotiations with a number of other East Asian nations (Park 2002: 4). In addition, several more BSAs were concluded in 2002, including a $1 billion agreement between Thailand and Korea and a $2 billion BSA between Thailand and China (BOT 2002: 119). By 2003, thirteen ASEAN+3

6 The special facility is known as the 'Asian Currency Crisis Support Facility', which through the ADB provides assistance to Malaysia, the Philippines, Thailand and South Korea. See also Hughes (2000).

BSAs totalled $33 billion (Yoshihiro 2003). However, doubts have been raised as to whether the amounts of liquidity raised would be enough to serve as a credible and effective system of defence against currency attacks. Short positions on the baht alone in mid-1997, for example, were estimated at $27 billion (de Brouwer 2004a: 280). But as with the Manila framework and the Miyazawa Initiative, the importance of the CMI, as Bird and Rajan argue, is that it is:

> An important step toward the eventual creation of a full-fledged regional monetary facility (2002: 48).

Indeed, a regional monetary facility may be shortly realised. The May 2004 ADB meeting reaffirmed its commitment to expanding the CMI and the $36.5 billion of BSAs now negotiated into a single multilateral facility (ADB 2004). The pooling of BSAs would not only establish a single fund, it would also enhance integration in other areas such as monitoring and surveillance. This proposal, coupled with ASEAN-commissioned research into common currency arrangements with a long-term view towards a monetary union, suggests financial integration in Asia is just beginning (de Brouwer 2004a: 280).

In this light, the recent moves towards regional financial integration suggest that an AMF is increasingly likely. Li Lin and Rajan argue that a regional monetary facility would be the natural evolution of the moves already taken (2001: 103). Hook *et al.* go as far as to suggest that the steps taken represent the creation of an AMF 'in all but name' (2002: 193). While such a claim appears a little far-fetched, the path towards an AMF has definitely begun. The increasingly significant role played by Japan in the region, as evident in the Miyazawa Initiative and the CMI, reflects Japan's growing commitment to East Asia.

However, the capacity of the region to confront US opposition remains critical if an AMF is to be established. The steps already taken suggest that a constituency in Asia, premised on a deep dissatisfaction with the US-IMF handling of the crisis, is being cultivated. There is already discontent within Asia that their individual and collective voices are under-represented in international forums like the IMF. Former Japanese Finance Minister Miyazawa argues that despite a rising share of world GDP (from 10% in the 1950s to 25% in the 1990s), Asia has received no comparable increase in IMF representation (Rapkin and Strand 2003: 3). Likewise, Katada (2002) argues that the desire for regional initiatives reflects East Asian beliefs that they are overwhelmed by the political power of the US and its associated institutions. For example, under overt US pressure for not doing enough to stimulate its own economy or to assist Asia during the crisis, the Japanese Ministry of Finance published an english report entitled ' Misperceptions and Truth about Economies of Asia and Japan' (1998) in effort to rebuke US criticism (Katada 2002: 93).

The resentment and desire for alternatives is not exclusively Japanese. Even Thailand's finance minister, a known IMF supporter, met with the Japanese Vice-Minister for Finance Sakakibara in November 2000 to emphasise continuing interest in the AMF, as did South Korea, putting aside its oft cited suspicion of Japan (Katada 2002:103). In addition, China's decision not to devalue the Yuan and its maintenance of trade deficits with most of East Asia illustrate its increasingly active role in the region. The evidence suggests that a regional constituency is building as Asia moves towards political consensus about financial arrangements. This is particularly important in a region where legal agreements have never been favoured, but where consensus and mutual support are historically the means for successful cooperation.

The proposal for an AMF could also become more politically palatable to the US as budgetary constraints and resistance from Congress to increasing finance to the IMF makes Asian-funded solutions more appealing. Helleiner (2000: 21) argues that the waning desire of Western politicians to provide funds for international aid and financial rescue packages will precipitate alternative approaches. But an AMF that is more politically palatable must not sacrifice its autonomy or it will risk becoming a co-opted regional arm of the IMF. Indeed an AMF would compete with the IMF. As Wade and Veneroso point out:

> Of course the AMF would compete with the IMF. But the IMF wants competition for others, and should not be averse to it for itself (1998a: 20).

Regional and international arrangements will also be facilitated by the steps that have been taken in the fight against money laundering. The increase in money laundering activity and the recent focus on freezing the financial means of 'terrorist organizations' have led to a strong set of cooperative regulatory initiatives. Helleiner points out that policymakers are recognising that the 'anti-money laundering regime'[7] has created cooperative structures at the international level which can be useful for other regulatory purposes. The G-7 already intends to use the mechanisms to address tax evasion, and there are signs that they may also be useful for controlling capital flight in specific situations (Helleiner 2000: 22). Meanwhile, an increasing number of countries have shown their willingness to cooperate. Thailand, for example, recently passed a new money laundering act (Bangkok Post 2003: 1). Although it is unclear at this stage where the agreements on money laundering will lead, the willingness of many East Asian nations to cooperate is sure to enhance the prospects for an AMF. Moreover, the cooperation against money laundering suggests that more work should go into revitalising plans for new regulatory arrangements at the international level.

More locally, it is uncertain whether financial cooperation in Asia will, in any meaningful sense, involve Australia and the Asia-Pacific. Most substantiative financial arrangements since the crisis have emanated from ASEAN+3 an institution in which Australia carries little weight. For example, despite making financial pledges to assist the crisis-hit countries in 1997 Australia was excluded from the ASEAN+3 process (Soesastro 2003: 3). In APEC where Australia does have a more prominent role financial cooperation is largely piecemeal and symbolic. Second, Australia and the Asia-Pacific were largely immune from the formative experiences of the 1997-1998 financial crisis. While the devastation in East Asia was the catalyst for cooperation, no such motivation exists in Australia nor does it appear imminent. Indeed, the Australian Treasurer Costello argues that the greatest contribution Australia can make to règional financial security is 'through the ongoing demonstration of the benefits of undertaking and maintaining economic

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7 The 'anti-money laundering regime', as Helleiner (2000) calls it, is led by the Financial Action Task Force (FATF) which was set up by the G-7 in 1989. In essence, it seeks to enhance the ability of governments to stamp out money laundering activity within its borders. The FATF actively promotes the international harmonization of domestic laws and practices and, encourages international information sharing and legal cooperation between governments.

reform' (Business Asia 2003: 8). Finally, without the aforementioned motivation it is unlikely that Australia would desist from pursuing ever-closer ties with the US in time to be part of an increasingly probable AMF.

Conclusion

The creation of an AMF is warranted. The destabilising factors endemic within financial markets and the high risk of illiquidity in Asian financial systems, especially those that remain bank-based, requires an adequately resourced credit facility to provide a quick and sufficient injection of funds to pre-empt currency runs and restore market confidence. The failings of the IMF on this front and the evident advantages of an AMF, particularly its prospective appreciation of Asian financial systems, demand the creation of an AMF that can discriminate correctly between the weaknesses of East Asian economies and the factors endemic within financial markets.

A failure to establish an AMF would ensure future crises of liquidity again turn into crises of insolvency. That would be a repeat of the experiences of 1997-1998 where economies collapsed, unemployment soared, and more people were pushed below the poverty line. Prudential regulation and debate over a 'new financial architecture' must appreciate that financial markets are crisis prone. However, while the case for an AMF is strong, so is the opposition from the US and IMF. This opposition represents the main hurdle to the creation of an AMF, as was evident in 1997. Nevertheless, the steps that have been taken since the crisis suggest that the creation of an AMF is increasingly likely. The question, now, is not if but when.

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