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Thinking ahead for Europe



Lessons from the Asian Monetary Fund for the European Monetary Fund

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The euro area is facing a challenge with Greece in danger of falling into sovereign default and some of its other members, the so-called 'GIPSY' nations,¹ finding themselves in serious financial distress. Creation of a European Monetary Fund² to deal more effectively with this type of situation is gaining support. This paper draws lessons from the Asian experience that might be applied to the current European development.

The Asian Monetary Fund is on its way. It started with the Chiang Mai Initiative (CMI), which was the only initiative that became a reality at the East Asian level following the East Asian financial crisis of 1997-98. The CMI was a series of bilateral currency swap arrangements among the ASEAN +3 countries, the three being China, Japan and Korea. With the aim of providing short-term liquidity to a partner country in serious financial distress,³ the volume of the bilateral contracts signed has increased, but they have never been used, even during the peak of the last financial crisis.⁴ This was in part due to the fact that the area has a high savings rate and the amount of money on which a country can freely draw⁵ is not sufficiently large.

¹ Daniel Gros, *Adjustment Difficulties in the GIPSY Club*, CEPS Working Document No. 326, March 2010, CEPS.

² Daniel Gros and Thomas Mayer, *How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund*, CEPS Policy Brief No. 202, February 2010, CEPS.

³ This initiative was agreed at the ASEAN +3 finance ministers' meeting held in Chiang Mai, Thailand, in May 2001. As of April 2009, the total contracts with the CMI amounted to \$93 billion, according to the author's own calculations.

⁴ For example, Korea made a bilateral currency swap arrangement with the US in late 2008, which helped to ease the anxiety of Korea's exchange market.

⁵ An IMF conditionality applies to the CMI, which enables 20% of the swap arrangements to be drawn without the IMF's consent.

Limitations like these, combined with efforts to provide a better safety net and more efficient financial resource allocation for the region, have resulted in a new initiative called the Chiang Mai Initiative Multilateralization (CMIM).

CMIM as precursor to the Asian Monetary Fund

The CMIM was agreed in the ASEAN +3 finance ministers' meeting held in Bali, Indonesia, on 3 May 2009. With a total contribution of \$120 billion (about €82 billion at an average 2008 annual euro/dollar rate), the CMIM is an establishment of a fund from which a member nation can swap its national currency for US dollars within a pre-determined maximum. The following table shows the contribution of the fund and the maximum amount that each country can withdraw.

Note that the withdrawal rates ensure that smaller contributors are given full credit for their contributions. The IMF conditionality holds the same under the CMIM as in the CMI. A purchasing multiple of 5 entitles the country to have full access to its contribution. It should also be noted that there was some competition among the countries to have more shares. China and Japan were tied at 32%, which is smaller than their GDP shares. Both Korea and the ASEAN countries have more shares than their GDP shares, with Korea at 16%, and the ASEAN members at 20%. The major reason behind the competition is the belief that the allocation will have a lasting impact on the voting power of the member countries in building future regional institutions. East Asia is in the early stages of regional economic integration and the CMIM is a virtually unique achievement in the process.

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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 by its purchasing multiplier. The last column indicates the proportion of the GDP (in US dollars, 2008) of the nation in the total GDP of the CMIM nations.

The CMIM is a commitment with no actual submission of money, and therefore not a physical establishment like an ordinary fund. However the legal documents of agreement and a regulatory framework have been circulated and signed. The entity came into

effect on the 24th of March 2010. It is expected that a surveillance body of the CMIM will soon be set up in one of the ASEAN cities. When the CMIM has such an institutional structure in place, it will effectively become an Asian Monetary Fund.

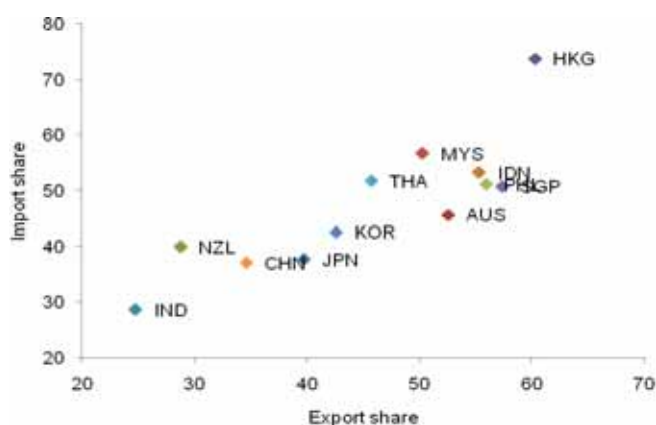
Table 2. A comparison between the EMF and AMF

	European Monetary Fund	Asian Monetary Fund
Function	<ul style="list-style-type: none"> • Sovereign fund to bail out countries in crisis 	<ul style="list-style-type: none"> • Expected to act as a regional monetary stabiliser. There is no regional currency and thus exchange risks are present all the time. A high level of foreign reserves in the region, however, makes the role of this fund somewhat limited.
Establishment/enforcement	<ul style="list-style-type: none"> • Countries with a higher likelihood of a crisis will have to contribute more. Little competition toward larger contribution shares. • No IMF conditionality, but possibly conditionality at the EU level 	<ul style="list-style-type: none"> • Competition towards a higher contribution, as the allocations within the AMF will be likely to impact the politics of future Asian regional institutions. • IMF conditionality
Link with regional economic integration	<ul style="list-style-type: none"> • A step forward although complementary to other initiatives in European monetary integration. The eurozone has the euro as a single currency, the ECB, and other institutions, e.g. the European Commission and the European Parliament. 	<ul style="list-style-type: none"> • Offers a significant symbolic representation of progress in East Asian financial integration.

A significant step forward for Asia

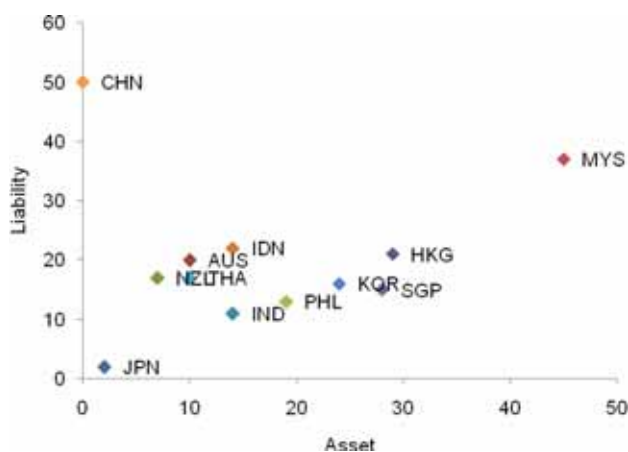
Formation of the Asian Monetary Fund is a significant step towards improving Asia's financial stability.⁶ East Asia is an area where real economic activities are strongly linked. As the following figures show, the share of trade in goods and services between East Asian countries is high, while transactions in financial assets are not as high. This implies that East Asia is well integrated in real economic activities, but less so in financial activities.

Figure 1. Strong linkage in real activities of Asia: Regional trade share, 2007 (percent)



Source: Baek and Oh, "Global Crisis and Currency Competition in the Asia-Pacific Region", in Y. Oh (ed.), *The World Economy with the G-20*, CEPR-KIEP, 2009, based on data from the IMF, *Direction of Trade Statistics*, April 2009.

Figure 2. Regional share of total portfolio investment, year-end 2007 (percent)



Source: Baek and Oh, "Global Crisis and Currency Competition in the Asia-Pacific Region", in Y. Oh (ed.), *The World Economy with the G-20*, CEPR-KIEP, 2009, based on data from the IMF, *Direction of Trade Statistics*, April 2009.

⁶ See also Henning, *The Future of the Chiang Mai Initiative: An Asian Monetary Fund?*, Policy Brief 09-5 (2009), Peterson Institute for International Economics, Washington, D.C.

These countries do not have a currency of their own in settling trade. Trade contracts are settled mainly in US dollars. Gains from real economic integration – low production costs, higher production levels, competitive advantages for consumers, etc. – can easily be lost by losses in currency values vis-à-vis the US dollar. This sort of situation happened during 2008-09 as in 1997-98. Some call this a currency crisis in contrast to the financial crisis. The relatively limited exposure to developed markets by most of the Asian financial firms has helped Asian countries. But foreign exchange markets have been hit badly, partly because foreign investors withdrew their portfolio investments out of Asian markets. The Asian Monetary Fund to be developed from the CMIM will primarily target the stabilisation of foreign exchange markets in the region.

Another important feature of the CMIM is that it collects savings created within East Asia and uses them only for the contributing nations. It effectively circulates Asian savings within the region. Its creation is a more significant step than the old CMI scheme, because not only the size of the pool available to member countries is larger, but its extension into an Asian Monetary Fund will send a strong message in support of the development of regional financial markets.

There are remaining tasks. The independent surveillance mechanism is expected to be working within the next two to three years at best. Support from the +3 countries, in particular China, is ambiguous. Equally important, East Asia will have to make the fund a useful and perhaps popular resort of financing. It will compete against high savings and reserves of the region, as well as the IMF.

So, is the creation of an Asian Monetary Fund an excessive choice? The answer would be no. Maintaining large foreign reserves is a costly business. China for example has the largest amount of foreign reserves in the world. If the US dollar falls in value, not only does the value of the US dollar-denominated assets held by China fall, but the renminbi will face strong revaluation pressures. If the US recession continues, this will reduce demand for Chinese exports, exacerbating the economy's woes. Smaller economies like Korea face a similar set of challenges. How effective the IMF lending facilities will become following the G-20 reform process remains questionable. Therefore, there are sound arguments in favour of developing an Asian Monetary Fund.

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