

The Prospects of East Asian Monetary Cooperation and China's Roles

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Since the 1997-98 Asian financial crisis, monetary cooperation has become one of the most popular discussions in this region. Much has been said and some have been done in support of establishing an appropriate East Asian¹ Monetary Cooperation (EAMC) mechanism. However, after the Chiang Mai Initiative was reached in May 2000, the EAMC seems to come to a hard time. This paper begins with examining the challenges faced by EAMC, then analyzing the prospects of EAMC and China's roles in promoting monetary cooperation among the East Asian economies.

The Challenges faced by East Asian Monetary Cooperation

It should be said that the movement of EAMC has begun during the 1997-98 Asian financial crisis. At the height of the Asian crisis, Japanese financial authorities proposed to set up an AMF at the G7-IMF meeting in

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¹ The East Asian is defined as ASEAN+3 countries, that is ASEAN countries and China, Japan, Korea. Usually ASEAN+1 means ASEAN countries and China.

Hong Kong during 20-25 Sept. 1997. “The rescue package for Thailand in fact marked the beginnings of an Asian fund, the new part of the idea is to prepare such funds in advance of the crisis, instead of raising them after the crisis has struck.”² In Nov. 1997, Manila Framework was reached with the purpose of creating a mechanism for regional economic surveillance to complement the IMF’s global surveillance³. In Dec.1999, ASEAN +3 was formed and became the main driving force in promoting EAMC through its various initiatives. These initiatives cover ASEAN+3 surveillance process, the Chiang Mai Initiative, capital flow monitoring and early warning system and so on. The third ASEM (Asia Europe) Finance Minister’s Meeting held in Kobe, Japan, in January 2001 endorsed the Kobe Research Project⁴. The Fourth ASEM Finance Ministers’ Meeting, held in Copenhagen in July 2002, accepted the Kobe Report which suggests a three-step program into a single Asian currency. Both Asian Development Bank and various institutes within member states of the ASEAN+3 group have done lots of studies on the possibilities and feasibilities of EAMC.

² Pangetsu, Mari. “The rescue package for Thailand in fact represented the beginnings of the Asian Fund.” Is the Asian Fund a winning idea?” Capital Trends 2, no.13, November 1997. <http://www.gwjapan.com/ftp/pub/nrca/ctv2n13d.html> (5 May 2001).

³ Besides this aim, the Manila Framework also has the following three aims: enhanced economic and technical cooperation in strengthening domestic financial systems and regulatory mechanism; measures to strengthen the IMF’s capacity to respond to financial crises; a cooperative financing arrangement that would supplement IMF resources.

⁴ The Kobe Research Project was endorsed by the ASEM (Asia Europe) Finance Minister’s Meeting held in Kobe in January 2001. The whole research includes six studies and was presented to the Fourth ASEM Finance Ministers’ Meeting, held in Copenhagen in July 2002. The full text of the Kobe Research is available at www.boj.go.jp

Although EAMC has progressed significantly in the past 6 years, it still faces great challenges, some of which seems hard to overcome. The opposition or disagreement from the US and IMF seems to be the first challenge to EAMC. The main opposition focus on moral hazard and duplication.⁵ The US and the IMF are concern that EAMC's liquidity provision will postpone domestic policy adjustment, which subsequently lead to encourage moral hazard. The creation of EAMC is also considered as adding very little to the pre-existing IMF architecture and has the possibility to underscore the authority of IMF. When Japanese financial authorities first released AMF program in 1997, the US and IMF initially opposed any suggests of EAMC on the grounds that it was unnecessary and ineffective. After Horst Köhler became the managing director of IMF in 2000, the IMF turned to support the regional self-helping monetary cooperation as complement to itself. To maintain IMF's primacy, the Chiang Main Initiative provides that 90% of the bilateral swap facility should be linked to IMF conditionality with only 10% unconditional disbursement. In this connection, the Chiang Main Initiative, which can be seen as the most fruitful achievement of EAMC, is strictly within the ambit of IMF.

The EAMC's second challenge is from the inharmonic states between the

⁵ Phillip Y. Lipsy, Japan's Asian Monetary Fund Proposal, Stanford Journal of Asian Affairs. Volume 3, No.1, Spring 2003.

main states in the region. Quite different with the west Europe countries, the East Asian countries are full of diversity and heterogeneity. There remain serious disputes or even conflicts regarding frontier, historical legacy, ideology and so on. It is well known that the close cooperation between France and Germany is the backbone for European integration and the same kind of cooperation between China and Japan is also hoped to play a key role in promoting East Asian integration. Due to lots of reasons, there are frequently political, trade frictions between two sides and this will seriously hinder the emergence of a *de facto* yen peg system. Both China and Japan want to hold the leadership position in EAMC separately rather than jointly. Presently, the long-term stagnation of Japanese economy and China's undeveloped financial system, lacking well-performed financial norms make neither China nor Japan actually play the leading role in this integration campaign.

The third challenge faced by EAMC is the reluctance of East Asian countries to subject their monetary sovereignty to an external institution. By now, there is little, if any, policy coordination amongst East Asian economies, not to mention any action in monetary integration. Because of the American hegemony in Asia establishing post World War II, all the East Asian currencies were *de facto* pegged on the US dollar. During 1990s, the intra-regional trade was relative low except Singapore and

Malaysia, some East Asian countries are sizable competitors in foreign markets such as America and Europe.⁶ Since the formation of ASEAN+3 group, the East Asian countries began to realize the importance of co-coordinating their macroeconomic policies and monetary policies.

The Prospects of East Asian Monetary Cooperation

The prospects of EAMC depend on the extent at which the east countries can meet the challenges mentioned above. As far as the first challenge is concerned, the prospects of EAMC are determined by the possibility of whether the reform of IMF can make EAMC unnecessary and the how far the East Asian countries can go beyond the Chiang Mai Initiative. The capabilities of East Asian countries meet the latter two challenges will determine the speed of EAMC progress.

The possible IMF reform in relation to EAMC is concerned with establishing Contingent Credit Lines (CCL) to provide rapid rescue to countries with potential crisis and increasing quotas for Asian emerging market countries. CCL has been introduced in 1999 and its purpose is to fight against financial contagion and is available to countries pursuing

⁶ A.Lahrèche-Révil and A.Bénassy-Quéré, China in a Regional Monetary Framework, Kobe Research Project, ECB Seminar, April 15-16, 2002.

strong economic policies.⁷ Although IMF has expressed several times that it will reconsider the distribution of its quotas in order to correct the under-representation of a number of emerging market countries since Horst Köhler took IMF in May 2000, there is still no concrete measures to implement the adjustment of quotas. In fact, the dissatisfaction of East Asian countries with IMF mainly derives from its austerity of conditionality, hard negotiation and insufficient financial supports. IMF's bailout policy is often criticized as imposing austerity upon countries in crisis⁸, notably Malaysian government refused to accept IMF's rescue package in 1997-98 financial crisis. It is claimed that IMF is the last institution willing to lend to a country in crisis, but the negotiation process is hard and time-consuming, the delay of negotiation will definitely make a country's situation worse. Take Thailand as an example, Asian countries bilateral commitments accounted for 55.2% to Thailand rescue package compared with mere 23.3% from IMF in Asian financial crisis. Therefore if IMF's reform can make EAMC unnecessary, it should totally extinguish all three concerns raised by East Asian countries. So far IMF's reform is quite limited vis-à-vis the requests from East Asian countries. It seems impossible that IMF's limited reform will prevent East Asian countries from promoting monetary cooperation. On the contrary, encouraged by the success of Euro and other regional monetary

⁷ <http://www.imf.org/external/pubs/ft/exrp/what.htm#box4>.

⁸ <http://www.imf.org/external/np/exr/ccrit/eng/crans.htm>.

cooperation mechanisms,⁹ EAMC seems unavoidable.

The current situation of Chiang Mai Initiative can be seen as the outcome of the latest game among these three countries. It is doubtless to say that the Chiang Main Initiative sends a strong signal to financial markets, especially the international financial speculators, that the contracting states can get liquidity supports if hit by crisis. It is premature to say that the Chiang Mai Initiative constitutes the foundation for a monetary system for East Asia.¹⁰ The most serious problem with the Chiang Mai Initiative is that the contracting countries failed to articulate the ultimate its objectives. Since Chiang Main Initiative was signed in May 2000, there is no significant progress being achieved. The main reason underlying is that it is an equilibrium state among China, Japan and US. As for China, given its bright future, it has no strong incentive to expand the Chiang Mai Initiative. US is satisfied with the Chiang Mai in that it only leaves 10% of liquidity provision unconditional on IMF's conditionality, 90% conditional on IMF's. Maybe Japan is enthusiastic about further expansion of the Chiang Main Initiative, but without supports from both China and US, it cannot make any progress. As shown in 1997 when Japan raised the proposal of AMF, US lobbied China to

⁹ Besides European Monetary Union, there are several different monetary cooperation forms in the world. These include Central American Monetary Union Council, Eastern Caribbean Central Bank, Gulf Cooperation Council Monetary Union, West African Economic and Monetary Union, the Economic Community of West African States. More details can be found in http://www.singleglobalcurrency.org/monetary_unions.html.

¹⁰ Seok-Dong Wang and Lene Andersen, Regional Financial Cooperation in East Asia: the Chiang Main Initiative and Beyond, Bulletin on Asia-Pacific Perspectives 2002/03, at p. 96.

oppose it by emphasizing the threat of Japanese hegemony.

From the perspective of game theory, the prospects of EAMC to a large extent are decided by the new round of game among China, Japan and US. Since US is a traditional dominant position in the region post World War II, and Japan gradually becomes a dominant country since 1960s by exporting and investments. China, as a rising regional power, is seeking opportunity from its neighboring countries. It is inevitable that the three powers will engage a new round of economic game. A significant phenomenon is that the recent competition between China and Japan in the creation of free trade areas with ASEAN. In 2002, China and ASEAN signed a complete economic co-operative framework agreement targeting at creating China-ASEAN free trade area in 2010. The planning China-ASEAN free trade area will be the largest free trade area in the world comprising 2 billion populations, US\$ 3000 billion GDP. In the past 10 years, the bilateral trade has grown by 6 times. Japan and US are also engaged a free trade agreement with Singapore respectively and are negotiating with other ASEAN members. The two striking features of China-ASEAN cooperation are: fast growth and China's great openness of its agriculture product markets. From Jan. to Aug. in 2003, the China-ASEAN trade grew by 43%, even the region is exposed by the attack of SARS. It is hoped that the trade between two sides will amount

to US\$ 100 billion in 2005, a level equal to the current trade between Japan and ASEAN. In Oct. 2003, China-Thailand Fruits Agreement was enforced, and From 1 Jan. 2004, the Early Harvest Plan between China and ASEAN is put into operation. All these agreements are concerned with the exports of agriculture products from ASEAN to China. Compared with Japan's hard stance in openness of agriculture product markets, China has made and will made great progress with ASEAN in creating free trade area while Japan is still just in the process of talking and talking.

China-ASEAN's progress in free trade area makes Japan worry about China's hegemony. To dilute China's influence, Japan resorts to seek a large free trade area including Australia, New Zealand and even US. In 2003, Japan announced it would reduce greatly ODAs (Official Development Aids) to China and increase ODAs to India. In the new round of game, US is engaged in Iraq War and reconstruction, has no energy to launch a great campaign against China and Japan. In theory, the optimal precondition for EAMC is the close cooperation between China and Japan. Only if China and Japan can cooperate closely, then EAMC can make great progress in the context of ASEAN +3 even with oppositions from US. The reality is that no one can push these two sides together, both sides still fail to recognize the benefits from cooperation. It

can be predicted that the result of China-ASEAN free trade is that China will gain a dominant position in ASEAN countries while Japan's and US's importance will diminish. Based on the knowledge that financial integration is an integral part of a successful free trade area, maybe the future EAMC will follow a modality under ASEAN +1 architecture when China-ASEAN free trade area is near complete.

The Kobe Report imagines a three-step program to lead to a single currency by the end of 2030, the main aims of these three respective steps are: a currency basket system, an effective surveillance process, and a single currency. Actually a successful EAMC should gradually complete five phases: information exchange, liquidity provision, policy coordination, target foreign exchange rate planning and monetary integration. Information exchange is proved to be the easiest field achieved, East Asian countries have engaged in information exchange and policy dialogue post crisis. The implication of Chiang Mai Initiative should not be understood beyond the establishment of liquidity provision facilities. To achieve the latter three aims requires an institution setting and transferring of some monetary sovereignty. In the respect of institution setting and monetary sovereignty transfer, there are still great challenges ahead to overcome. Therefore it is sure that EAMC comes to a hard time and a further progress calls for a breakthrough of the current

deadlock.

To push EAMC forward calls for an appropriate regional approach. The Functionist and Neo-Functionalist approach plays an important role in promoting European integration. According to the Functionist, European integration should start with several sectors that are the easiest area to align together. The transformation history of European Coal and Steel Community to European Economic Community then to European Economic and Monetary Union has set up a good example of the Functionist and the Neo-Functionist. In view of the diverse economic, social and political background among the East Asian economies, a practical approach is to start off with a few small monetary unions rather than a large monetary union in the region. Many researches¹¹ conclude that currently EAMC is still at the very early stage, keeping in mind the target of single Asian currency, there are lots of things to be done to promote substantial convergence among East Asian economies. From the point of this view, the current creation of free trade areas is also a kind of progress in promoting EAMC.

¹¹ For example, Dai Jinping and Xiong Xinmei calculated series of indices which are regarded as being capable of measuring the closeness of the East Asian economies during 1985-1999 and compared them with the figures of European Community in 1970s. Their research concluded that EAMC can only stay at an infant stage and there is no basis for cooperation in connection with foreign exchange rate stabilization. See, Dai Jinping and Xiong Xinmei, The Determination of East Monetary Cooperation Stages and the Cooperative Forms, Nankai Economics Studies, Issue 4, 2001 at p.27.

China's Roles in Promoting East Asian Monetary Cooperation

China is expected to be East Asia's largest importer and exporter respectively in 2005 and 2020. It is also claimed that China has the potential to be the largest economy in the world. To most East Asian economies, it is inevitable that China will become their largest trading partner. China's rapid growth economy greatly changes the landscape of East Asian economy. In 2003, although Chinese economy was hit by SARS seriously, its FDI replace US and became the largest one in the world, its GDP increased by 9.1%, a highest level since 1997, foreign exchange reserves grew by more than 40.8%, amounting to a new historic record level: US\$403.3 billion¹². It is the first time that China's per capital GDP exceeds US\$ 1000, maybe this is the most important achievement in 2003. According to the growth experiences in Korea and Japan, US\$ 1000 per capital GDP is a critical point for economic development, since then it will take a quite short time to double and double its per capital GDP. So this implies that China is now staying at a first economic expansion period, Chinese leaders name it as an important strategic opportunity period. The enhancing economic power makes China can play a quite important role in promoting EAMC. The optimal roles for China to play can be summarized as the following.

¹² <http://business.sohu.com/2004/01/18/61/article218666181.shtml>

Active participation. China should continue participate in further negotiation about EAMC. During 1997-98 financial crisis, China maintained its currency steady rather than excessive depreciation. This behavior fed back with common praises from East Asian countries, and was helpful to create a new imagine that China is a responsible big country in the region. China also joined rescue action to Thailand and Korea in the height of financial crisis. Chinese central bank also plays a vital role in safeguarding the steady of Hong Kong dollar in 1997. So far, China has actively participated in almost every important negotiation regarding EAMC and will continue to do so.

Active promotion. In the early 1990s, there was strong belief among ASEAN countries that China's rising would constitute a threat to their prosperities. From the middle 1990s on, China has succeeded to eliminate this kind of negative influence and confirmed that China's rising is an opportunity for them. In 2003, China joined the ASEAN treaty and concluded CEPAs with Hong Kong and Macao, also succeeded in resisting the pressure of appreciating its currency from Japan, US and others. Under Chinese active promotion, Shanghai Cooperative Organization was put into operation in January 2004. In 2004, China will adopt lots of measures to implement the Early Harvest Plan with ASEAN.

The best option for China should be making good use of the kind environment with ASEAN and actively promote EAMC negotiations further.

Gradual progress. With undeveloped financial system, the appropriate strategy for China is to promote EAMC through promoting intra-region trade, substantial convergence in the fields such as fiscal policy, sound finance practices, effective financial supervisions and so on. In 2003, China established its Banking Supervision Authority to strengthening supervisor on commercial banks. China's two largest state-owned insurance companies were successfully listed, one in Hong Kong and the other in Hong Kong and New York. Its two main stated-owned commercial banks were input US\$ 45 billion to further boost their capital reserves and are planned to be listed soon. The prospects of EAMC will largely depend on future developments of China's trade relations with the rest of East Asian economies.¹³ Being confident that East Asia integration will be centered on it, China's best choice will be promoting regional convergence while strengthening its financial systems.

Conclusions

¹³ C.Fre Bergsten and Yung Chul Park, Toward Creating a Regional Monetary Arrangement in East Asia, ADB Institute Research Paper 50, December 2002.

The Chiang Mai Initiative may be seen as the peak and most receptive EAMC forms at the current stage. The challenges faced by EAMC will make it hard to further progress. Currently promoting free trade area may be a practical and feasible Asian functionalist way of promoting EAMC. In this field, China as a pioneer in creating China-ASEAN free trade area can play an enhancing and vital role in promoting EAMC.

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