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Beyond ASEAN and APEC: Towards a New Asia-Pacific Economic Regionalism

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INTRODUCTION

Just weeks before the onset of the Asian financial crisis in July 1997, the Association of Southeast Asian Nations (ASEAN) celebrated its 30th anniversary. The atmosphere was jubilant as it also marked the induction of Laos and Myanmar as new members of ASEAN. It now seemed that the long-cherished goal of ASEAN's founding members (Indonesia, Malaysia, the Philippines, Singapore and Thailand) of making the association an all-inclusive body, incorporating all countries of Southeast Asia (the so-called ASEAN 10) would soon become a reality.[1] Indeed, ASEAN could do no wrong as it seemed to have solutions to all manner of regional problems. Besides creating the ASEAN Regional Forum (ARF) in 1991 to promote dialogue between the United States, China and other regional powers on strategic issues, it was also a major supporter for the creation of the Asia Pacific Economic Cooperation (APEC), to facilitate economic cooperation and integration among countries in the Asia-Pacific

1) Cambodia joined ASEAN in 1999, making the goal a reality.

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region. Established in 1989, the distinctive regional grouping called APEC soon became the leading forum for political and economic collaboration in the Asia-Pacific region. Comprising twenty-one diverse member states from the region, including the world's three largest economies (China, Japan and the United States), APEC was granted a broad agenda to promote trade and economic cooperation. Specifically, in 1994, APEC members signed the Bogor Declaration, which set target dates for eliminating trade and investment barriers. Developed nation members of APEC pledged to eliminate trade and investment barriers by 2010, while the developing nation members agreed to follow suit by 2020. In 1997, APEC members reached an important agreement on accelerated elimination of tariffs on information technology products. This agreement was forwarded to the World Trade Organization (WTO), where it was eventually adopted.

When the financial crisis struck, it was widely expected that both ASEAN and APEC would use their considerable authority and work in tandem and find solutions to the crisis. However, as the following sections illustrate, this was not the case. In fact, both organizations remained indecisive and ineffective as recession and economic collapse took their toll in country after country in the region. No doubt, ASEAN and APEC's inability to respond effectively to the crisis have eroded the confidence and prestige in these institutions. While both organizations will continue to play important roles in the region, it is also clear that countries of the Asia-Pacific are now also looking at other forms of economic regionalism.

ASEAN'S AND APEC'S RESPONSE TO THE CRISIS

On 1 December 1997, a Special ASEAN Finance Ministers meeting in Kuala Lumpur to discuss the causes and policy responses to the crisis, the ministers failed to come up with any ASEAN financing arrangement to assist the affected countries—in large part because almost all the major players were themselves financially strapped. In fact, ASEAN's one and only concrete response to the regional financial crisis was its decision to set up the ASEAN Surveillance Process following the ASEAN Ministerial Meeting in mid-1998. The aim of the Surveillance Process was to provide recommendations on possible actions member countries could take to deal with economic challenges. However, the ASEAN Surveillance Process did not outline any measures to deal with the immediate problem of the financial crisis in its midst.

APEC's response to the crisis was hardly better. As noted earlier, with its establishment in 1989, APEC has made remarkable progress as an institution. In timely fashion it graduated from a ministerial-level gathering of twelve countries to an institution that stages annual summits of "Economic Leaders" of its twenty-one members.[2] Today, APEC has an established permanent Secretariat, while the APEC ministerial working groups hold more than thirty meetings each year. Clearly, what separates APEC from other regional economic groupings like the European Union or the North American Free Trade Area (NAFTA) is its non-discriminatory approach to trade liberalization—an approach its members call "open regionalism." Under this approach APEC extends trade concessions to members and non-members alike on a most-favored-nation (MFN) basis. Moreover, unlike other regional agreements, APEC has eschewed legally binding agreements. Trade liberalization is to occur voluntarily, with individual member economies given discretion in deciding how much flexibility they will exercise in meeting their goal to establish free trade in the region by the year 2010 for

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2) The founding members of APEC were the (then) six member states of ASEAN, or the Association of Southeast Asian Nations (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand), plus Australia, Canada, Japan, New Zealand, South Korea and the United States. The "three Chinas" (Hong Kong, the People's Republic of China, and Taiwan) were admitted in 1991. Mexico and Papua New Guinea joined in 1993, Chile in 1994, and Peru, Russia and Vietnam in 1997.

developed economies, and 2020 for less developed economies.

APEC's achievements and ambitious agenda was seen by many as the key to economic cooperation and sustainable economic growth in the Asia-Pacific region. However, its failure to respond effectively to the Asian financial crisis has tarnished the organization's credibility. Currently, Asian nations who are members of APEC are seriously looking at other forms of regional institutions and organizations, in particular, strategies that can help them navigate through the challenges of economic globalization. The next section provides an assessment of the new thinking about Asian regionalism.

WHAT KIND OF ASIAN REGIONALISM?

Given the failure of APEC and ASEAN to deal with the financial crisis, what does the future hold for regionalism in the Asia-Pacific. Does Asia's long term salvation lie in a new East Asian Regionalism? Obviously many Asian governments think so. In fact, the single greatest push for an East Asian regionalism has been the Asian financial crisis. The commonly-held view in Asia (especially Korea and the ASEAN countries), was that they were let down by the West (in particular, the United States and Japan) during the crisis. In their view, since western banks and financial institutions from the G-7 countries had created and exacerbated the crisis by suddenly pulling their funds from the region, then it was only appropriate for western governments to provide assistance. The fact that G-7 governments either declined to individually take part in the rescue operations (as was the case of the United States and Japan with Thailand), or they required excessively stringent demands through the International Monetary Fund (IMF), only served to intensify the feeling of betrayal. At the same time it was widely believed that the United States (through the IMF), was not only dictating flawed policy responses to the crisis, but also that these self-serving policies had worsened the crisis by pushing Asian economies into a deeper economic recession. As Bergsten notes:

> The single greatest catalyst for the new East Asian regionalism, and the reason it is moving most rapidly on the monetary side, is the financial crisis of 1997-98. Most East Asians feel that they were both let down and put upon by the West. In their view, western banks and other lenders created much of the crisis by pulling out. The leading financial powers then either decided to take part in the rescue operations, as the United States did in Thailand, or built the much-bally-hooed "second lines of defense" so deviously that they could never be used. At the same time, the IMF and the United States dictated much of the Asian response to the crisis.[3)]

Whatever the merits of such thinking, it is clear that Asian governments now agree that they must reduce their dependence on the G-7 countries and multilateral financial institutions like the IMF or the World Bank. Perhaps, most significantly, the much celebrated APEC has been severely compromised. APEC's failure at its Vancouver Leaders' Meeting in November 1997 to support Japan's proposal for an Asian Monetary Fund and its endorsement of the centrality of the IMF to the resolution of the crisis, alienated many Asian governments from the organization. However, one cannot conclude that Asian countries are rejecting multilateralism and global economic integration. Rather, it seems, that they want their own institutions and a bigger say in regional economic matters. More diplomatically, Asian countries claim that a regionally focused facility may be able to design more appropriate conditionality than the IMF because of the former's superior regional expertise and its closer geographical proximity to member countries.

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3) Fred Bergsten, "East Asian Regionalism," *The Economist* (July 15, 2000), p. 24.

The Asian Monetary Fund

The idea of the Asian Monetary Fund (AMF) dates back to August 1997 when Thailand approached the Japanese government for financial assistance. In response, Japan along with several member countries of ASEAN proposed setting up a separate monetary fund to provide emergency financing to countries affected by the economic crisis. The proposal was enthusiastically welcomed as the ASEAN nations were only too eager to see Japan take on a greater leadership role (i.e. in the economic sphere) in the region. Moreover, there was anticipation that the conditions attached to AMF resources would not be nearly as strict as those required by the IMF. However, in its public relations campaign, ASEAN claimed that the AMF would not only promote regional cooperation and trust, but that there was a real economic rationale for such a body. Specifically, since trade tends to be regional, the affected region loses disproportionately from trade disruptions caused by currency crises. Thus, it made sense that the regional governments work in unison to prevent the spread of financial crises. It was also argued that the AMF, like the Arab Monetary Fund and the Latin American Reserve Fund, would complement the IMF.

By the end of September 1997, it seemed that the AMF would become a reality. The Japanese government pledged an initial US $50 billion, while an additional US $50-60 billion was to be raised through contributions from the China, Taiwan, Hong Kong and Singapore.[4] It was argued that the AMF and its financing arm, the Regional Financing Facility, would provide sufficient liquidity that could be quickly mobilized to forestall speculative attacks on the region's currencies. Also, unlike IMF assistance, funds from the AMF was to be unconditional, taking into account the individual needs of

4) Masaru Yoshitomi, and Sayuri Shirai, "Policy Recommendations for Preventing another Capital Account Crisis," *ADB Technical Background Paper* (Manila: Asian Development Bank, July 7, 2000), pp. 67-69.

the member countries. As expected, the United States and the European Union were unequivocal in their objections. First, they argued that unconditional financial assistance would increase the risk of moral hazard, and second, that an independent AMF would undermine the IMF because of the potential conflicts in their policy guidelines for member states. In the end "Japan decided to give up the proposal in November 1997, owing to the opposition by the United States and the IMF on the grounds that such an arrangement would enhance the problems of moral hazard and double-standards."[5] Wade and Veneroso,[6] more bluntly note that "the United States Treasury pulled out all the stops to kill the proposal, and it died."

Although the proposal for the AMF did not get off the ground, the ASEAN finance ministers at the November 1997 APEC Summit in Vancouver agreed to establish a cooperative arrangement of regional surveillance (called the Manila Framework Group) through better coordination between the member states finance ministries and central banks. The Framework included the following initiatives: (1) a cooperative financing arrangement that would supplement IMF resources, (2) enhanced economic and technical cooperation, particularly in strengthening domestic financial systems and regulatory capacities, and (3) a mechanism for regional surveillance to complement the IMF's global surveillance. To further enhance cooperation, the ASEAN finance ministers (on October 4 1998), formed the ASEAN Surveillance Process (ASP) to promote closer consultations of economic policies. The ASP has two major elements: (1) to monitor global, regional and national economic and financial developments, and (2) to provide a forum where ASEAN finance ministers can share information and jointly develop collective action programs to counter potential threats to any member country as well

5) *Ibid.*, p. 68.

6) Robert Wade, and Frank Veneroso, "The Resources Lie Within," *The Economist* (November 7, 1998), p. 19.

as the region.[7)]

On 3 October 1998, Japan formally proposed a "New Initiative to Overcome the Asian Currency Crisis." The most ambitious was the "Miyazawa Initiative." Under this plan, Japan pledged US $30 billion to support the crisis-hit countries. Half of the pledged amount was to be dedicated to short-term capital needs during the process of implementing economic reforms. The rest was earmarked for medium and long-term reforms. By February 2000, US $21 billion had been committed, with US $13.5 billion for medium and long-term reforms. Korea has been the largest recipient (US $8.4 billion), followed by Malaysia (US $4.4 billion), and Indonesia and Thailand with US $2.9 billion each, and the Philippines (US $2.5 billion). The initiative has supported economic adjustment, financial and corporate restructuring, social safety nets, infrastructure and export financing. In the second phase of the initiative, Japan has partially guaranteed sovereign debt issues, enabling countries to use limited public resources to mobilize private capital, thereby promoting private debt markets.[8)]

The Chiang Mai Initiative

About a decade ago, Malaysian Prime Minister Mahathir Mohamad proposed the creation of an exclusive "Asian" East Asian Economic Group (EAEG) comprising the ASEAN countries, China, Japan and South Korea. Concerned about the emerging trade blocs in Europe and North America, Mahathir's undeclared objective was to persuade the mentioned countries to shift their economic strategies along the lines of its own "Look East Policy"—with Japan as the

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7) In addition to the usual monitoring of exchange rates and macroeconomic aggregates, the ASP also monitors sectoral and social policies, including provisions for capacity building, institutional strengthening and sharing of information.

8) World Bank, *East Asia: Recovery and Beyond* (Washington, D.C.: The World Bank, 2000), pp. 152-153.

economic focal point. The EAEG proposal received lukewarm support from Asian countries (including Japan), and was strongly opposed by the United States, Australia and New Zealand because it was felt that the EAEG would undermine the incipient APEC forum.[9)]

The organization that actually expanded (with strong American backing) was the broad-based APEC. However, in the aftermath of the Asian financial crisis, the ASEAN countries hastily created the "ASEAN+3" (comprising the 10 member countries of ASEAN, plus China, Japan and South Korea) as envisaged earlier by Mahathir. Since December 1997, informal ASEAN+3 Summits have been convened on an annual basis. It has already set up a "vision group" to explore ideas for cooperation and has been holding regular meetings of its finance ministers.

Besides setting up the vision group, the central task of ASEAN+3 has been to establish a surveillance mechanism to anticipate and head off future financial crises. Top-level discussion has also taken place regarding common currency baskets and joint intervention arrangements—to replace both the discredited dollar pegs of the past and the costly free floats imposed by the crisis.[10)] Most dramatically, at the thirty-third annual meeting of the Board of Governors of the Asian Development Bank meeting in Chiang Mai, Thailand in June 2000, the finance ministers of ASEAN+3 committed their countries to even greater regional cooperation under the new "Chiang Mai Initiative." Specifically, they announced their agreement to share foreign exchange reserves (through a region-wide system of currency swaps and repurchase arrangements), in order to defend their currencies against speculative attacks. The finance ministers

9) Although some Japanese officials viewed the EAEG proposal favorably, the Japanese government had to oppose it publicly in the face of strong opposition from the United States.

10) Although the finance ministers of ASEAN+3 met for the first time in Manila in April 1999, top-level discussions have been taking place since mid-1997.

reasoned that providing countries under pressure with short-term hard currency liquidity would act as a firewall against future financial crises. To show their commitment, the ASA (ASEAN Swap Arrangement) was endowed with a fund of US $1 billion which would be available as of 17 November, 2000. While the repurchase agreements (repos) are designed to allow ASEAN members with collateral such as US Treasury Bills to swap them for hard currency, and then repurchase them at a later date, it is hoped that the hard currency lines of credit can be made available to members without strict linkages to repos. Indeed, under the initiative, ASA is to be made available for two years and is renewable upon mutual agreement of the members. Each member is allowed to draw a maximum of twice its committed amount from the facility for a period of up to six months with the possibility of a further extension which is not to exceed six months. In addition to ASA, members are encouraged to establish bilateral swap arrangements. In April 2001 Japan signed a bilateral swap arrangement with Malaysia, Thailand and Korea totaling some US $6 billion. As of July 2002, seven bilateral swap arrangements (BSAs)—Japan-Korea, Japan-Thailand, Japan-Philippines, Japan-Malaysia, PRC-Thailand, PRC-Japan, and PRC-Korea with a combined size of US $19 billion—have been concluded and signed. The most recent one was signed between the PRC and Korea on 24 June 2002. There has also been significant progress on three BSAs (Korea-Malaysia, Korea-Philippines and Korea-Thailand). While negotiations on another four have started, negotiations on four more have yet to be initiated. In addition, in line with the Chiang Mai Initiative, the existing swap arrangements between Japan and Korea and Japan and Malaysia have been renewed with a combined size of US $7.5 billion. While the maximum amount that can be withdrawn under the bilateral swap will be determined by the two countries, in the spirit of regional cooperation, all member states will be fully consulted when deciding the size of the disbursements.

Moreover, in keeping with the signed Chiang Mai Initiative, ASEAN+3 have committed themselves to work towards cooperation. In March 2001, the ASEAN Task Force on the ASEAN Currency and Exchange Rate Mechanism was established with the ambitious task of working towards harmonizing the macroeconomic and exchange rate policies of member countries. Moreover, there is agreement to work towards a common market and a single Asian currency unit on the euro model. Even the IMF has given its blessing to this goal. In fact, the fund has expressed support for any regional initiative as long as it is complementary with that of the IMF. The IMF recently noted that "regional initiatives can be helpful in supporting sustained economic growth and stable financial relations among participating countries. In this vein, the recent Chiang Mai Initiative among ASEAN members and China, Korea and Japan is an important example of enhanced regional cooperation through which countries in temporary financial difficulties will be able to obtain foreign exchange from their neighbors through swap and repurchase arrangements."[11)] In this context, some have argued that the Chiang Mai Initiative is like the European Monetary System (EMS) type arrangement. However, this seems a bit of an exaggeration. After all, the exchange rate mechanism (ERM) of the EMS provided for automatic and unlimited support of bilateral pegs. That is, the arrangement conveyed an essential message to the markets: any attempt to spilt any one currency from the others is bound to face strong official resistance since the central bank is committed to put up unlimited amounts of its currency as a defense. In contrast, the amounts to be swapped within the Chiang Mai arrangement are limited and unlikely to be commensurate with the amounts that markets can mobilize.

In the end, how all these initiatives will actually work in practice remains to be seen. However, what once seemed like a pipe-dream, is no longer that. The growth of cross-border trade is driving Asian

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11) International Monetary Fund, "Recovery from the Asian Crisis and the Role of the IMF," *IMF Issues Briefs* (June, 2000), p. 9.

economies inexorably towards closer cooperation. Suffice to say, the demands for regional arrangements to ensure currency stability and more efficient regional exchange transactions will grow. The Asian financial crisis vividly underscored that Asian countries have a vested interest in cooperating with one another to minimize systematic risk now inherent under globalization.