Rationales for Establishing Regional Financial Arrangements in Asia

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In the wake of the Asian Crisis, a strong consensus has emerged among policymakers, academics, and the media in favor of establishing regional financial arrangements (RFAs) in Asia. This consensus led to the Chiang Mai Initiative, which in 2000 proposed an expansion of existing Association of Southeast Asian Nations (ASEAN) swap arrangements as well as the establishment of bilateral/unilateral swap arrangements among the 10 ASEAN countries with People's Republic of China (PRC), Japan, and Korea (ASEAN+3). This move toward an RFA was remarkable, considering that a previous Japanese initiative—the Asian Monetary Fund (AMF)—floundered in 1997 in the face of strong opposition from the International Monetary Fund (IMF) and United States. Unlike this previous move, the Chiang Mai Initiative met with a favorable reception, even from IMF. This paper reviews existing financial arrangements as well as new initiatives and discusses the rationales behind them.

1. The Asian Monetary Fund and Japan's Initiatives

The idea for the AMF emerged in August 1997 when Japan together with several ASEAN member countries proposed financial support for Thailand. The proposal emerged in response to a request by Thailand for the creation of a regional scheme that could provide immediate financing for Asian countries affected by the economic crisis. The plan envisaged that the new scheme should be independent from IMF, with funding generated by a quota assigned to each participating country. In September 1997, Japan announced a more concrete plan for an AMF that could stabilize Asian currencies and financial markets. It would consist of a fund of about US$100 billion, with Japan contributing about half of this and the rest coming from the remaining member countries. Another function of the AMF would be regional surveillance to complement existing IMF activities in this regard. The possible membership envisaged was the (then) six ASEAN countries, plus PRC, Japan, Korea, Hong Kong, and Taiwan.

Despite growing regional enthusiasm for the formation of an RFA, Japan gave up on the proposal in November 1997, in the face of strong opposition from IMF and the United States. They objected on the grounds that such an arrangement would increase moral hazard problems, encourage double standards (IMF vs. AMF), and that any challenge to IMF leadership would be undesirable.

Consequently, instead of the AMF came a framework to strengthen Asian regional cooperation on financial and currency stabilization (the Manila framework) in November 1997. This framework recognized the central role of IMF in the international financial system and included in its agenda such functions as regional surveillance, strengthened economic and technical cooperation, measures to strengthen IMF's capacity to respond to financial crises, and a cooperative financing arrangement that would supplement IMF resources. Since then, Manila Framework meetings have been used to promote open discussions among regional policymakers on progress in addressing the crisis, and to review economic and financial policies.

In October 1998, Japan proposed a variety of financial schemes under the framework of "A New Initiative to Overcome the Asian Currency Crisis" ("New Miyazawa Initiative"). The initiative intended to provide a package of support measures totaling US$30 billion. Some US$15 billion would be made available for medium- to long-term financial needs to promote economic recovery in Asian countries, while another US$15 billion would be set aside to support possible short-term capital needs for economic reforms. The crisis-affected Asian countries were clamoring for such a fund to finance their corporate debt restructuring efforts, strengthen social safety nets, stimulate their economies, and address credit crunch problems.

The United States and IMF supported this initiative mainly because of its bilateral nature—in contrast to the AMF proposal, which had attempted to achieve cooperation on a multilateral basis. Another reason that this initiative garnered support was because its mandate stressed the assistance of crisis-affected Asian countries to overcome their economic difficulties, thus contributing to the stability of international financial markets. Within this framework, a bilateral swap agreement was also established between Japan and Korea (US$5 billion) and between Japan and Malaysia (US$2.5 billion).

2. ASEAN Financial Arrangements and the Chiang Mai Initiative

In 1977, the ASEAN central banks reached an agreement on the establishment of ASEAN swap arrangements—a reciprocal arrangement among Indonesia, Malaysia, Philippines, Singapore, and Thailand (ASEAN-5). The arrangement aims to provide immediate short-term swap facilities for US dollars against the domestic currency of a requesting member country experiencing temporary international liquidity problems. The swap transaction is for a period of one, two, or three months and is renewable once for a maximum of another three months. Each member country contributes US$20 million (total amount is US$100 million) and a requesting country is able to borrow up to US$40 million. In 1978, the total financial resources were doubled from US$100 million to US$200 million and each member country agreed to contribute US$40 million. Thus, a requesting country is now able to borrow up to US$80 million under the revised arrangement.

Since its inception, the ASEAN swap arrangement has been rarely used because of the availability of only a limited amount of US dollars. However, the importance of an RFA was recognized after the Asian Crisis erupted in July 1997. Reflecting strong support among policymakers, the Finance Ministers of ASEAN+3 countries—whose total foreign reserves amount to about US$800 billion —agreed in May 2000 in Chiang Mai, Thailand, to establish an RFA to supplement existing international facilities in Asia. This agreement—known as the "Chiang Mai Initiative"—involves an expanded ASEAN swap arrangement that will include all 10 ASEAN countries (ASEAN-10) and a network of bilateral swap and repurchase (REPO) agreement facilities among ASEAN+3.

The Chiang Mai Initiative has met with a favorable reception from various quarters, including IMF, for several reasons. First, the Initiative stressed the strengthening of the existing RFA at the center of ASEAN and its supplementary nature to IMF facilities. Second, presumably large-scale financial support from the +3 countries to ASEAN-10 is based on a bilateral agreement, compared with the multilateral arrangement sought by the AMF. Third, the severity of the Asian Crisis increased awareness among international financial organizations on the need for additional financial support at a regional level.

In response, discussions took place at the 7th meeting of the ASEAN Central Bank Forum in August 2000 on expanding the membership of the ASEAN swap arrangement to include the remaining five ASEAN countries—Brunei Darussalam, Cambodia, Lao People's Democratic Republic, Myanmar, and Vietnam—and also enlarging the size of the facility. In November 2000, ASEAN-10 signed a new ASEAN swap arrangement, which would increase the total financial support from US$200 million to US$1 billion (US$900 million from ASEAN-5 and Brunei, US$60 million from Vietnam, US$20 million from Myanmar, US$15 million from Cambodia, and US$ 5 million from Lao PER). A requesting country is able to borrow US dollars, yen, and euro against its local currency at a gearing ratio of 1:2. The new arrangement will be available for a period of two years, subject to renewal upon mutual agreement by the participating member countries. It was expected that the ASEAN swap arrangement would start operating by the middle of 2001.

With respect to the ASEAN REPO agreement, Bank Indonesia proposed in March 2000 that a repurchase transaction should be effected through a sale of US Treasury bills or notes with a remaining life of not more than five years against US dollars and should be accompanied by a simultaneous agreement to repurchase the same securities at a later date. The amount of REPO would be up to US$1 billion and the maturity generally less than a month. In September 2000, Dr. Olarn Chaipravat and Dr. Bhasu Bhanich Supapol, commissioned by the ASEAN Secretariat, proposed that eligible assets should include Japanese Government bonds or yen bonds in addition to US Treasury securities to improve the arrangement's flexibility. They also proposed that the total amount that could be borrowed would be US$2 billion under a new agreement. So far, no details have been produced regarding these two arrangements. But it is likely that details will be negotiated soon and that the arrangements will become effective by the end of 2001.

Regarding bilateral swap arrangements and the REPO agreement between ASEAN and the +3 countries and among the +3 countries, three main points should be noted. First, the arrangement will supplement existing international financing facilities, including those of IMF. Nevertheless, there was intense opposition expressed concerning IMF's role, especially by Malaysia in November 2000. It has been agreed that member countries will be able to withdraw funds through this arrangement without any linkages to IMF programs, provided that the amount borrowed is within 10% of the maximum amount determined.

Second, the surcharge on the arrangement was originally envisaged as London interbank offered rate (LIBOR) plus 300 basis points (bp) for the first draw and an increase of 50 bp for every renewal up to a maximum of 500 bp. The surcharge has now been lowered to LIBOR plus 150 bp for the first draw (up to a maximum of 300 bp) in line with a change in the surcharge imposed by IMF on its Contingent Credit Line (CCL), as discussed below.

Third, each member country will enter into a bilateral agreement with each other at their mutual discretion with respect to the terms and conditions of the swap transactions undertaken. In May 2001, Japan agreed on a one-way bilateral swap arrangement with Thailand (US$3 billion), Korea (US$2 billion), and Malaysia (US$1 billion), in addition to its existing swap arrangements with Korea and Malaysia, respectively, as mentioned above. In the same month, the PRC announced that it would enter into negotiations with Thailand although it is not clear whether the bilateral arrangement will be two way or one way.

3. Constraints to the IMF-led International Financial Architecture

The announcement of the IMF-led rescue packages did not help restore investors' confidence or prevent the affected countries' economy from deteriorating further during the Asian Crisis. It is widely recognized that the Korean crisis was contained not on December 4, 1997, when the IMF package of US$57 billion was formulated, but on December 29, when the Federal Reserve Board engineered a rollover of short-term debts (Sachs, 1999).

Further, while the announced official packages for Indonesia, Korea, and Thailand—involving IMF, World Bank, Asian Development Bank (ADB), and bilateral contributors—were large, they turned out to provide less financing than expected for two reasons (Boorman et al., 1999). First, the second lines of defense announced by some bilateral creditors, such as Japan and the United States—particularly for Indonesia and Korea—were never disbursed. While IMF managed to mobilize US$117 billion for Indonesia, Korea, and Thailand from its own resources and contributions from the World Bank and ADB, bilateral contributions for Indonesia and Korea were only a second stage backup, with considerable uncertainty about the circumstances under which they would become available.

Second, the disbursement was phased and conditional. This was intended to ensure that a borrowing country would implement IMF-led economic policies, thereby countering one form of moral hazard. Thus, the potential risks associated with failure of recipients' repayment inevitably urged IMF to impose additional conditions at the time of disbursement. Such phased, conditional disbursement makes it difficult for crisis-affected countries to obtain the immediate and substantial financing that is necessary to deal with a capital account crisis, as exemplified by the Asian Crisis (see Yoshitomi and Ohno, 1999; and Yoshitomi and Shirai, 2000). Also, such a slow disbursement would not prevent a credit crunch, which deepens recession.

These two reasons explain why external assistance did not arrive quickly and in volume to the crisis-affected countries, thus delaying their reaction to the credit crunches and recessions they faced.

IMF as a Crisis Lender

Stanley Fischer (1999), Deputy Managing Director of IMF, stated that the organization is capable of functioning as a crisis lender to member countries provided that the New Arrangements to Borrow (NAB) or General Arrangements to Borrow (GAB), and special drawing rights (SDRs) are used, and that member governments and other international financial institutions participate in the rescue package. The total resources of IMF are US$279 billion as of January 2001. However, this amount includes nonusable resources, such as holdings of gold, and the currencies of countries that are using IMF resources or in a weak balance of payments position. The total resources also include committed usable resources under existing arrangements. Thus, subtracting nonusable and committed resources from the total resources leaves usable resources of US$96 billion. After adding the balances available under GAB and NAB, lendable resources amount to US$140 billion. IMF's liquidity position, defined as the ratio of its net uncommitted usable resources to its liquid liabilities, reaches 152%. The fact that the US$117 billion committed by IMF and other international institutions to tackle the Asian Crisis was not sufficient suggests that IMF resources, as they stand, fall short of what is needed.

Fischer (1999) admitted that if IMF were today the same size relative to the output of its member countries as it was in 1945, it would be more than three times larger. Also, if the quota formula applied in 1945 were used to calculate actual quotas today, IMF would be five times its current size. And if the size of IMF had been maintained relative to the volume of world trade, it would be more than nine times larger. Nevertheless, Fischer stressed that the decline in the size of IMF relative to the likely borrower base is acceptable, since most of the rich countries that were potential borrowers in 1945 are now unlikely to borrow from IMF. This argument, however, appears weak if the scale and speed of capital flows and the nature of the new type of crisis are taken into account. The capital account crisis originated from massive, short-term, unhedged capital inflows, followed by a sudden massive reversal. Masson et al. (1999), who are staff at IMF, admitted that IMF resources are relatively small compared to the size of international claims and potential capital movements. Ito (1999) claimed not only that IMF's financial support is not large enough to relieve private creditors, but also that the program is not supportive of compulsory renewal of debts. Such a middle-ground approach, he stressed, hampered the affected Asian countries from promptly stabilizing market confidence and prolonged the crisis, leading to contagion.

Also, Fischer's view that IMF could arrange a financial package in collaboration with other international financial organizations and governments appears optimistic since there are no guarantees that such collaboration is always swiftly made. Further, Ahluwalia (1999) questioned whether the World Bank and regional development banks should be involved in meeting the needs of crisis financing, because these institutions would be distracted from their primary function—providing long-term development finance. The World Bank should be free to negotiate adjustment lending separately for crisis-hit countries, and such lending may well be needed as part of structural and more micro-oriented reforms in the postcrisis phase.

To increase IMF's resource base, Ahluwalia (1999) suggested that the IMF Articles of Agreement should be amended so that it could issue SDRs to itself for use in lender-of-last resort operations, subject to a cumulative limit on the total volume that could be created. Once a crisis is contained, SDRs created for this purpose should be extinguished on repurchase by the borrowing country and linked with appropriate conditionality. In this way, IMF could avoid a permanent increase in unconditional liquidity, as would happen in the case of a general allocation of SDRs.

IMF as a Crisis Manager

Fischer (1999) stated that IMF is able to act as a crisis manager in addition to being a crisis lender. He argues that the main function of a lender of last resort is to act as a crisis manager—a role that does not necessarily require vast amounts of capital. A crisis manager helps a crisis-affected country design a reform program, assesses financing needs, facilitates communication with lenders and private sector creditors, provides or arranges for necessary technical assistance, and monitors compliance.

However, it is widely recognized that initial IMF-supported programs implemented by Indonesia, Korea, and Thailand contained not only inappropriate policies but also ones not related to the causes of the crisis. Since this failure reflects lack of deep understanding of Asia-specific problems, it is questionable whether IMF is capable of helping to design appropriate programs. For example, IMF tends to recommend that the capital adequacy requirement is an important indicator of banking system soundness. Nevertheless, this indicator is meaningless when illiquid and inactive equity markets are present, stockholders of banks are connected to bank borrowers, and accounting and judiciary systems are underdeveloped, as is the case in many Asian countries.

IMF Reform Initiatives

Since the Asian Crisis, IMF has initiated reforms of its facilities. First, it introduced the Supplementary Reserve Facility (SRF) in December 1997.[1] SRF aims to provide liquidity support for one year, without any general access limits, to a country suffering serious balance-of-payments problems caused by a sudden and destructive loss in market confidence. SRF applies to a country that could recover in a relatively short period from a crisis once sufficient foreign exchange is provided and appropriate economic polices are implemented. It is tied to the existing Stand-by Facility and thus is a conditional

[1] Fischer (1999) emphasized that two elements of Bagehot rules (penalty rate and the notion of lending freely) have been incorporated into SRF. This is because SRF would provide short-term loans in an unlimited amount but would charge a penalty interest rate. But the third element (collateral lending) has not been met.

lending arrangement. Repayment is due up to 18 months later, although an extension is possible. The interest rate is a charge applied to the regular IMF facilities, plus 300 bp for the first year and an additional 50 bp each six months thereafter, to a maximum of 500 bp. The SRF was first applied to Korea in December 1997.

Further, IMF provided US$18.1 billion financing to Brazil in late 1998 under SRF. To help finance Brazil's drawings under the credit, IMF also approved the first activation of NAB. Of the total amount, US$5.3 billion was made available immediately with another US$15.7 billion by late 1999. This program differed from that in Korea for several reasons. First, a very large first tranche including additional financing from bilateral lenders was available. In Korea, there was a very large first tranche under SRF, but bilateral financing was a second line of defense and came only much later. Second, the Brazilian program was accompanied by a floating tranche. Generally, the second tranche would be available only after a certain date, typically three months or longer after the first tranche. However, in the Brazilian case, provided that the program would be on track and the need would arise, the disbursement of the second tranche could be advanced a few months. Third, the size of the second tranche, if conditions were met, could be as large as the first one. For these reasons, Brazil's program could be regarded as one kind of contingent reserve facility.

While SRF may better cope with a capital account crisis, such flexible disbursements are exceptional arrangements and thus have been treated on a case-by-case basis. Further, concerns that a phased-in disbursement with limited resources available up front may not prevent a capital account crisis from deepening remain valid. Also, the issue of how to raise sufficient funding for IMF has not been resolved.

Second, IMF introduced CCL in April 1999 in order to prevent capital account crises. The difference between SRF and CCL is that the former is intended for a country already in a crisis, whereas CCL is a preventive measure intended solely for a country concerned with potential vulnerability to contagion, but not yet facing a crisis.

The availability of CCL is tied to ongoing performance criteria or preconditions. The surcharge is the same as that applied to SRF. To be eligible for CCL, a country's performance should be assessed positively in the last Article IV consultation and thereafter. Also, a country should adhere to international standards, have constructive relations with private creditors, submit a satisfactory program, and have an activation review. CCL is tied to IMF's traditional financing facility, the Stand-by Facility, and funding is available up to 300-500% of each member country's quota. These criteria aim to resolve moral hazard problems, since a borrowing government could no longer be expected to be bailed out if it ignored warnings of imprudent behavior (Williamson, 2000).

However, CCL has been subject to several problems. First, once a country is accepted for CCL, it will be extremely unlikely to lose the qualification, since disqualification of a country previously qualified could precipitate a crisis (De Gregorio et al., 1999). In the end, this could just become a way to provide larger support packages with minimal discrimination between countries. Second, preconditions are arbitrary and not clearly defined, which may raise concerns about transparency. Third, countries do not have an incentive to apply for CCL because the application would be interpreted by the market as a sign of weakness and thus might precipitate the very crisis that the facility is intended to safeguard against (Williamson, 1999). Fourth, if a country drew on CCL and the amount proved inadequate to quell a speculative attack, the facility would simply have given the country a little more money to feed speculators before being forced into crisis. Fifth, the threat of withholding financial support from countries that have not prequalified is not credible (De Gregorio et al., 1999).

In response to some of these criticisms, IMF reformed CCL in September 2000. First, IMF provided clearer guidelines regarding preconditions. For example, a member country, in order to complete the activation review, needs to have successfully implemented the economic program that it presented to the IMF Board as a basis for its access to CCL resources. Since the condition could be viewed as implying a detailed assessment, IMF clarified that an activation review would be completed provided that a country's difficulties were judged to be largely beyond its control. Second, IMF divided the activation review into two: an activation review and a postactivation review. The former should be completed expeditiously and once completed, a predetermined large amount of financial resources would be disbursed. For the latter, IMF and the country should reach an understanding on policies to be pursued from that point onward with disbursement phased in and subject to conditionality. Third, charge on CCL resources was lowered from 300 bp to 150 bp. Fourth, the commitment fee on arranging CCL resources was lowered from the flat fee of 25 bp (applied to all IMF facilities) to (a) 25 bp on amounts committed up to 100% of quota and (b) 10 bp for amounts committed in excess of 100% of quota. However, even after these reforms, so far no country has applied for CCL.

4. Establishing a Regional Financial Arrangement

The above arguments indicate that IMF is not able to offer the immediate and measurable liquidity support that is needed as a crisis lender and crisis manager in resolving a capital account crisis.

The introduction of SRF and CCL was a welcome step since they were intended to deal with capital account crises. However, setting criteria for gaining access to such facilities that are applicable to all member countries increases the risk of a delayed response and inadequate policy prescriptions. Also, the limited size of IMF's financial resources and uncertainty surrounding collective action may make it difficult for the organization to offer such facilities to different member countries simultaneously.

Given that the current international financial architecture led by IMF has various problems and deficiencies, there is a growing demand in the Asian region for strengthened regional financial cooperation. In order to deal with capital flows reversals and contain any crises, it is crucial to establish an RFA. To make it workable, an RFA should have the authority to jointly monitor economic developments, and discuss and formulate major macroeconomic and financial policies in the region. These policies should also tackle such issues as volatility in financial markets of member countries and the problems associated with highly speculative activities, including hedge funds headquartered in developed nations.

And, most importantly, an RFA should have a facility for countries that suffer sudden liquidity problems in a capital account crisis. The facility needs to be designed in such a way that funds can be disbursed quickly to prevent a currency crisis from deepening, while at the same time minimizing the problems of moral hazard through effective monitoring. To reduce moral hazard problems, financial support should be tied to predetermined standards of macroeconomic and financial stability for member economies.

The extended ASEAN and bilateral swap arrangements may be in line with these arguments. However, there need to be more detailed discussions, especially regarding bilateral swap arrangements that involve a large amount of financial resources and thus accompany conditionality. It is important that regional financial support under an RFA should be automatic and disbursed up front. Under the current arrangement, the ASEAN swap arrangement can be automatic since no conditionality is involved. However, for bilateral arrangements, there is the condition that a requesting country should enter into IMF programs or have a high probability of doing so. Such a condition may delay the disbursement of funds needed to cope with a capital account crisis. It would be more appropriate for a member country to be subject to predetermined standards, with qualification based on regular assessments from regional surveillance. Also, the timing of applying conditionality to a requesting country should differ from that of disbursement of financial resources, like a revised arrangement of CCL. And the conditionality should contain only policies that are directly relevant to the causes of a crisis.

Last, there are other rationales for establishing an RFA. They are: (1) effective surveillance, (2) containing crises contagion to localized areas, (3) promotion of financial and corporate restructuring, and (4) providing a timely response to crises.

Effective Surveillance

With a more focused regional mandate and expertise, an RFA may perform better in conducting regional and bilateral surveillance, and obtaining detailed and timely information. Rana (2000) stresses that regional monitoring not only recognizes the complex links that are now being forged among neighboring countries, but also extends beyond macroeconomic fundamentals into structural and institutional policies, and social dimensions. Meanwhile, Sachs (1999) points out that peer pressure may work better at the regional level, as exemplified by Western Europe, which has a long history of mutual surveillance and monetary and financial cooperation. Also, monitoring through regional surveillance may reduce moral hazard problems.[2]

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[2] In line with these rationales, the ASEAN Finance Ministers signed a Terms of Understanding in October 1998 that would establish the ASEAN Surveillance Process and requested ADB support. The purpose of this initiative was to strengthen policy-making capacity within the region by

Localized Contagion of Crises

Crises tend to be localized and contagious through regional trade and financial linkages (Rose, 1998). Also, economic structures and conditions vary by region. For example, Asian economies are dominated by bank-based financial systems and highly geared corporate sectors. By identifying the factors that may spill over national borders and by seeking a joint solution for preventing adverse contagion in the region, the probability of having another capital account crisis might be lessened.

Rose (1998) stressed that a currency crisis tends to disrupt trade flows as exports increase through devaluation while imports drop due to recession. This is likely to trigger protectionism, which would generate distortions in trade. Since trade tends to be regional, efforts to support trade flows by reducing the likelihood of a currency crisis are warranted at a regional level. Eichengreen, Rose, and Wyplosz (1994) also emphasized the danger of contagion through instability in foreign exchange markets via trade links and macroeconomic similarity.

Asian trade linkages have been strengthening in recent years, and they are expected to grow further in the near future with the increasing attention given to regional trade integration. Since a region loses disproportionately from trade disruptions caused by a currency crisis, and crises tend to be regional, an RFA should try to prevent the spread of crises.

As for contagion through trade in financial assets, Kaminsky and Reinhart (1999) showed that regional financial sector linkages, particularly through commercial banks, are stronger than regional trade linkages in goods and services, based on the monthly data for 1970-1998 and 80 instances of currency crises. This finding is consistent with perceived cross-border spillovers, in which a bank with a marked rise in nonperforming assets in a country reduces the overall risk on its assets by pulling out of high-risk projects in other emerging-markets. Using daily data for 1995-1998, Baig and Goldfajn (1998) found a high degree of correlation and contagion between sovereign markets of Indonesia and Malaysia using the interest rate spread between US dollar-denominated debt and US Treasury bills. They also showed that based on changes in stock indices, the

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monitoring and sharing information on exchange rates and macroeconomic aggregates as well as sectoral/social policies. Under this framework, the ASEAN Finance Ministers meet twice a year for policy coordination.

Further, the concept of the Asian Recovery Information Center (ARIC) emerged at the meeting on Development Cooperation in March 1999 from a proposal by the Australian Government. ARIC was then established in ADB in November 1999 to provide an Internet-based facility with the following three objectives. First, ARIC is to monitor the social and economic impacts of the Asian crisis and the recovery process with a view to identifying the remaining policy agenda for a sustained social and economic recovery. Second, it aims to provide information on responses to the crisis by the international community, governments, nongovernment organizations, and civil society. Third, it attempts to monitor and contribute to discussions on policy reform in response to the crisis. However, this initiative is limited to the postcrisis situation and covers only five countries that were most affected by the Asian crisis.

equity markets between Malaysia and Thailand and those between the Philippines and Indonesia had high degrees of correlation during the crisis, but these were not very different from those in tranquil times.

Promotion of Financial and Corporate Restructuring

An RFA should promote the financial and corporate sector restructuring process among member countries, for example by fostering an environment that will facilitate cross-border mergers and acquisitions and by providing funds for such efforts (Wang, 1999). Further, an RFA should encourage a concerted move toward strengthening the soundness of the banking sector and fostering local- or regional-currency denominated bond markets for domestic firms (Yoshitomi and Shirai [2001]).

Timely Response to a Crisis

An RFA complements the international financial system by dealing with and quickly responding to regional-specific and small country issues, given that IMF has inadequate human resources and time to take care of the issues of all its member countries (Setboonsarng, 2000).

5. Conclusions

A recent active movement toward the formation of an RFA in Asia reflects growing awareness that the Asian crisis was a capital account crisis. It was unique in terms of its severity and impact on the real and financial sectors, the substantial adjustment imposed on the current account, the large scale of contagion to other Asian countries, and the degree to which exchange rates overshot, reflecting a reversal of substantial international capital flows. As a result, it is increasingly recognized that one of the policy packages needed to contain such a crisis is the formation of an RFA (see Asian Development Forum and ADB Institute [2000]). In this light, the initiation of extended ASEAN and bilateral swap arrangements among ASEAN+3 is a desirable trend. Nevertheless, it is crucial that the many unresolved issues are tackled in order to better cope with future capital account crises. These include how to improve the conditionality applied to bilateral swap arrangements, how to speed up and increase the amount of financial support, and how to strengthen regional surveillance and set preconditions for obtaining automatic withdrawals.

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