

Some Reflections on Regional Monetary Integration in East Asia

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I. Korean economy amid deepening global financial crisis

- The exchange rate of Korean won vis-à-vis the US dollar soared to 1500, the highest since the currency crisis.
- On the same day, the stock price dropped to below 1000. Compared to the peak point in December 2007, this was a drop of more than 50%.
- Foreign reserves dropped from more than 250 billion dollars to 200 billion dollars
- And output growth rate turned negative.

Fig1: Won Dollar exchange Rate from 1996 and 2010
(Monthly Average)

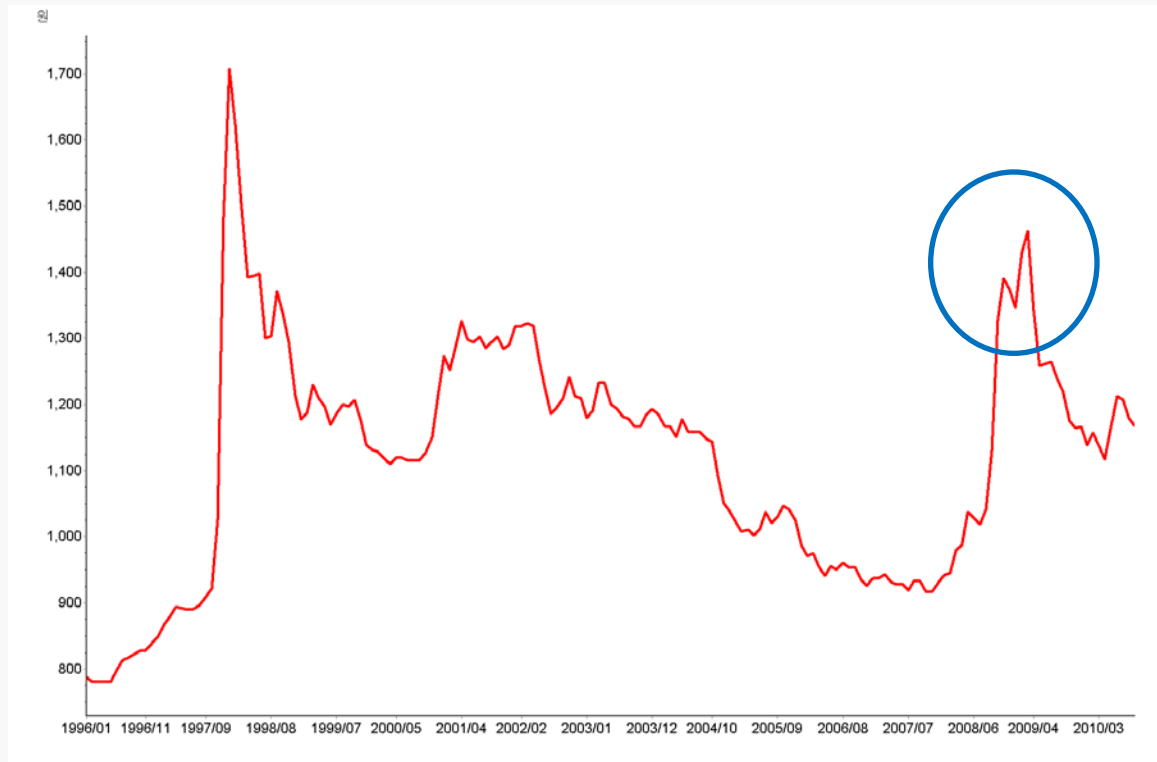


Fig2: Stock price trend



Fig3: Foreign reserve holdings between 1996 and 2010

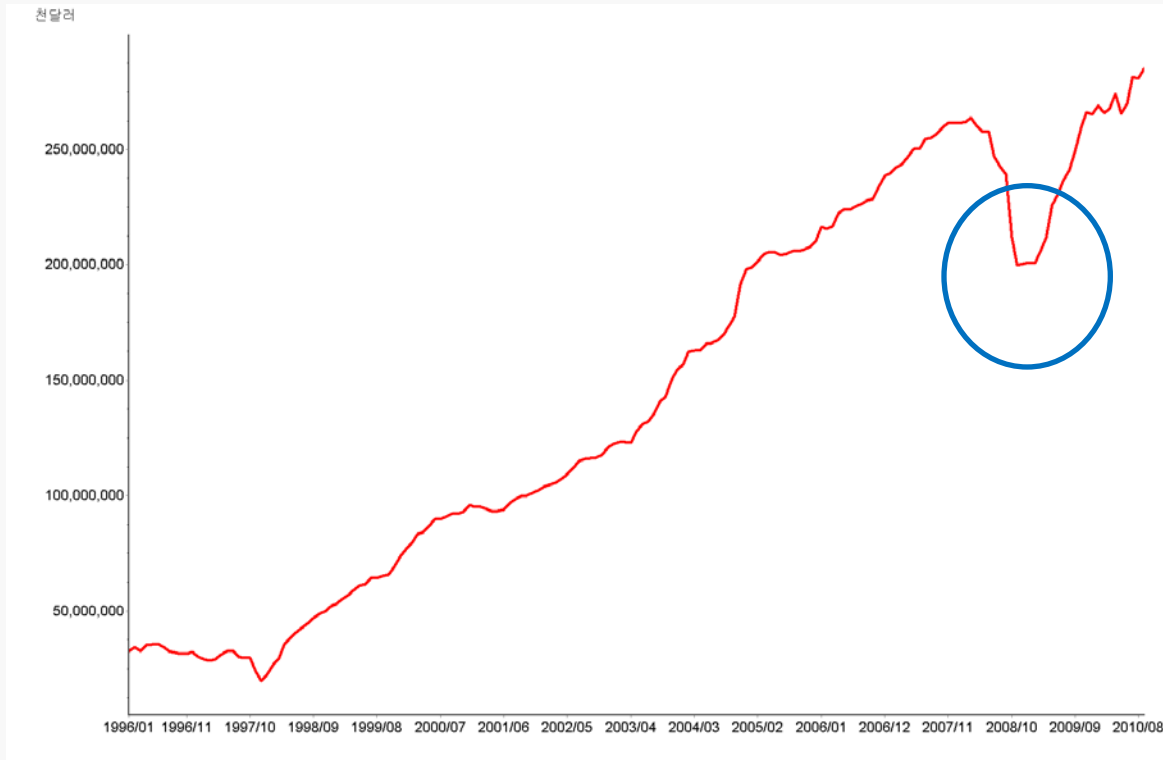
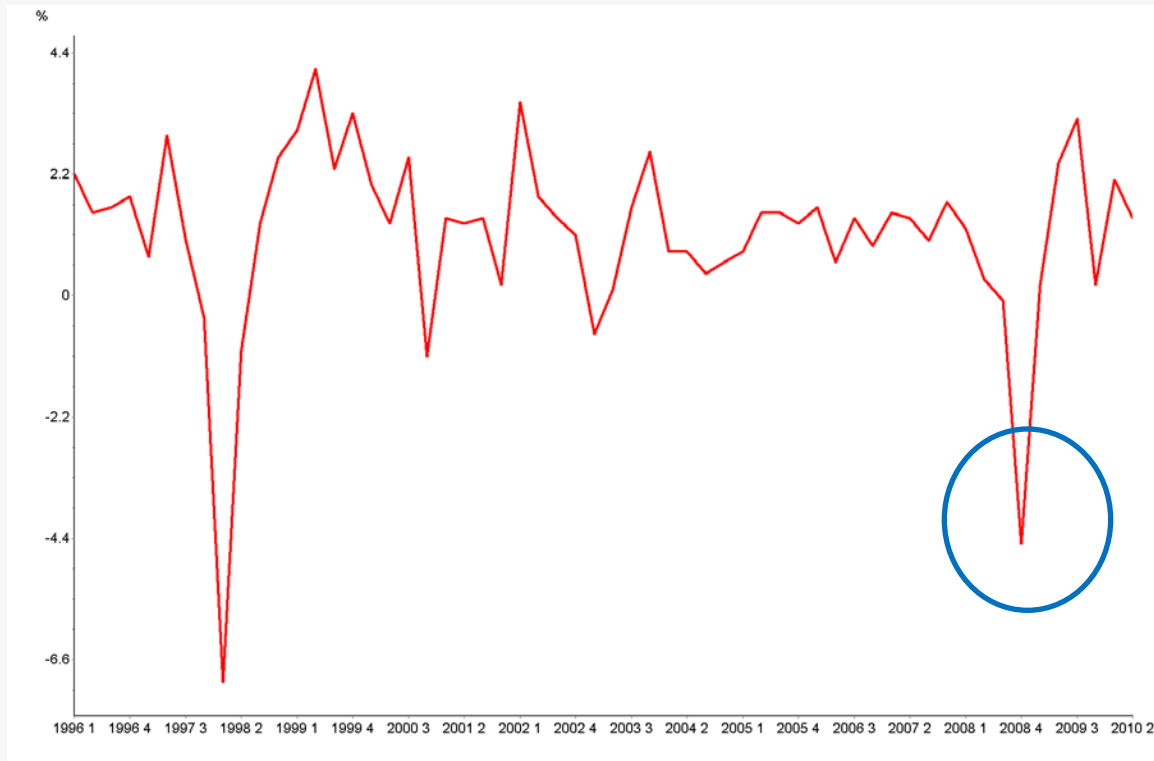


Figure 4: Growth Rate of Real GDP



- The skyrocketing Korean won was first of all the result of capital outflows triggered as mutual and pension funds in industrialized countries were trying to scale back their emerging market exposure but more importantly the result of Korean banks' incapacity to borrow the US dollar in one-sided and illiquid US money market generated by global crisis
- Korea had more than \$250 billion worth of foreign exchange reserves, but this large stocks of foreign exchange reserves (9 times as large as the foreign exchange reserves in 1997) did not help to stabilize the exchange market. The currency swap worth 30 billion dollars with the US helped Korean economy.
- What is then the implication of this recent financial turmoil? A comparison with 1997 financial crisis in East Asia might look a good starting point.

II. Which types of lender of last resort, multi-lateral or bilateral?

- In 1997, Korea could not rely on bilateral swaps but was forced to borrow from the IMF. The important question is about the choice between global and regional lenders of last resort.
- The “conditionality” for emergency loans imposed by the IMF and the US (behind the IMF) was ‘too harsh in the Korean crisis’ (Siebert(2008)). It led Korea to explore the possibility of building a regional lender of last incarnated by the CMI Initiative.

- This time, Korea could benefit from the bilateral swaps. The important question is which borrowing is better, bilateral or multi-lateral.
- Table 1 and 2 show that bilateral central bank swaps could mobilize much larger sums of money than the IMF did to cope with the 2008 global financial crisis.
- Furthermore, Figure 5-6 demonstrate that bilateral central bank swap was much more effective in stabilizing foreign exchange markets in Korea, compared to the IMF lending.

Table 1: Stand-by Facility of IMF As of March 30, 2009 (1000 SDR)

Country	Agreement Date	Due Date	Approval	Sums not used	Sums borrowed
Armenia	06-Mar-09	05-Jun-11	368,000	206,448	161,552
Belarus	12-Jan-09	11-Apr-10	1,618,118	1,100,320	517,798
El Salvador	16-Jan-09	31-Mar-10	513,900	513,900	0
Gabon	07-May-07	06-May-10	77,150	77,150	0
Georgia	15-Sep-08	14-Mar-10	477,100	189,200	287,900
Hungary	06-Nov-08	05-Apr-10	10,537,500	4,215,000	6,322,500
Iceland	19-Nov-08	18-Nov-10	1,400,000	840,000	560,000
Latvia	23-Dec-08	22-Mar-11	1,521,626	986,282	535,344
Pakistan	24-Nov-08	23-Oct-10	5,168,500	3,101,100	2,070,559
Serbia	16-Jan-09	15-Apr-10	350,775	350,775	0
Seychelles	14-Nov-08	13-Nov-10	17,600	11,440	6,160
Ukraine	05-Nov-08	04-Nov-10	11,000,000	8,000,000	3,029,625
Total			33,050,269	19,591,615	13,491,438

Table 2: Swap Agreements of FRB As of the end of 2008 (Unit: Billion dollars)

Central banks	Agreement Date	Due Date	Amounts
ECB	18-Sep, 2008	January 30, 2009	110
Bank of Japan	18-Sep, 2008	January 30, 2009	60
Bank of England	18-Sep, 2008	January 30, 2009	40
Swiss National Bank	18-Sep, 2008	January 30, 2009	27
Bank of Canada	18-Sep, 2008	January 30, 2009	10
Reserve Bank of Australia	24-Sep, 2008	January 30, 2009.	10
Sveriges Riksbank	24-Sep, 2008	January 30, 2009.	10
Danmarks Nationalbank	24-Sep, 2008	January 30, 2009.	5
Norges Bank	24-Sep, 2008	January 30, 2009.	5
Reserve Bank of New Zealand	28-Oct, 2008	April 30, 2009.	15
Banco Central do Brasil	29-Oct, 2008	April 30, 2009	30
Banco de Mexico	29-Oct, 2008	April 30, 2009	30
Bank of Korea	29-Oct, 2008	April 30, 2009	30
Monetary Authority of Singapore	29-Oct, 2008	April 30, 2009	30
Total			412

Fig. 5: Won-dollar Trend around the IMF Bailout Loan (27 Billion \$) at November 21, 1997

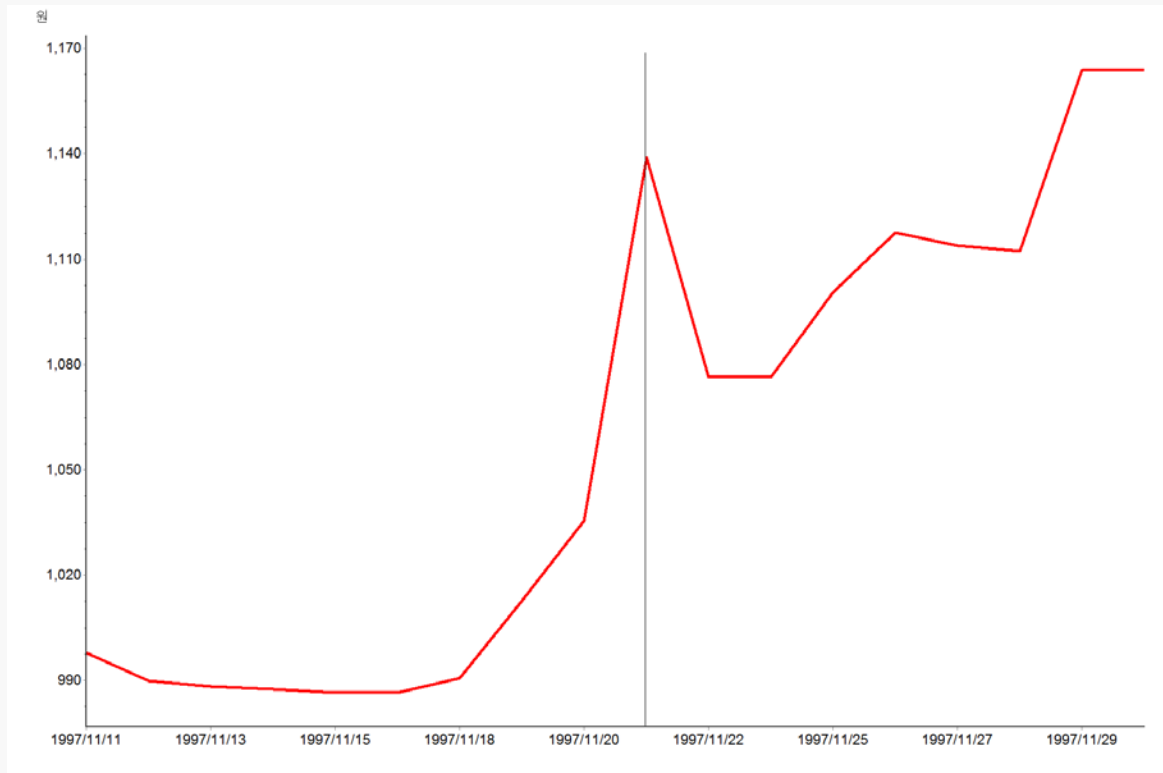


Fig. 6: Won-dollar Trend around the Kor-US Currency Swap (30 Billion \$) at October 29, 2008



III. Why did Korea decide to have a bilateral swap arrangement with the FRB?

- Although the CMI was an important step in establishing a regional monetary cooperation, it was not effective.
- It is so not just because of the IMF linkage but because of its inherent weakness.
- First of all, the amount of swap is still insufficient despite the fact that the total size of the swap pool was extended to US\$120 billion.

Table 1 CMIM Financial Contributions, Borrowing Agreements, and Voting Power

	Financial Contributions		Borrowing Agreements			Voting power			
	\$Billion	Share (%)	Multiplier	Maximum Swap Amount (\$Billion)	IMF De-linked Portion (\$Billion)	No. of Basic Votes	No. of Votes Based on Contributions	Total No. of Votes	Share (%)
Members									
Plus Three Countries	96.00	(80.00)	0.69*	57.6	13.20	4.8	96.0	100.8	(71.59)
PRC and HKG	38.40	(32.00)	0.72*	19.2	5.52	1.6	38.4	40.0	(28.41)
<i>PRC</i>	<i>34.20</i>	<i>(28.50)</i>	0.50	17.1	3.42	1.6	34.2	35.8	(25.43)
<i>Hong Kong, China</i>	<i>4.20</i>	<i>(3.50)</i>	2.50*	2.1	2.10	0.0	4.2	4.2	(2.98)
Japan	38.40	(32.00)	0.50	19.2	3.84	1.6	38.4	40.0	(28.41)
Republic of Korea	19.20	(16.00)	1.00	19.2	3.84	1.6	19.2	20.8	(14.77)
ASEAN	24.00	(20.00)	2.63	63.1	12.62	16.0	24.0	40.0	(28.41)
Brunei Darussalam	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Cambodia	0.12	(0.10)	5.00	0.6	0.12	1.6	0.1	1.7	(1.22)
Indonesia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Lao PDR	0.03	(0.03)	5.00	0.2	0.03	1.6	0.0	1.6	(1.16)
Malaysia	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Myanmar	0.06	(0.05)	5.00	0.3	0.06	1.6	0.1	1.7	(1.18)
Philippines	3.68	(3.07)	2.50	9.2	1.84	1.6	3.7	5.3	(3.75)
Singapore	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Thailand	4.77	(3.98)	2.50	11.9	2.39	1.6	4.8	6.4	(4.52)
Viet Nam	1.00	(0.83)	5.00	5.0	1.00	1.6	1.0	2.6	(1.85)
ASEAN+3	120.00	(100.00)	1.16*	120.7	25.82	20.8	120.0	140.8	(100.00)

Note: *Hong Kong, China's borrowing is limited to the IMF de-linked portion because Hong Kong, China is not a member of the IMF.

Source: The Joint Media Statement of the 12th ASEAN+3 Finance Ministers' Meeting, 3 May 2009, Bali, Indonesia.

Source: Kawai

- Second and more importantly, there is an absence of cooperation among the +3 and East Asian monetary cooperation has been led by the ASEAN countries (ASEAN centrality).
- However, ASEAN is an economic dwarf compared to the +3 countries in Northeast Asia. The ASEAN accounts for only 10% of the region's GDP and 20% of the quota for the CMIM, while the +3 represents 90% of the region's GDP and 80% of the CMIM quota. Most of the ASEAN members except for Singapore are also receiving official development assistances from the +3 countries.
- It means that although the CMIM develops into the AMF (maybe through the AMRO) it is unlikely that Korea considers it as a real regional lender of last resort.
- Indeed, in the case of global crisis, Korea concluded a separate bilateral swap with Japan and China. For instance, Korea had a swap agreements with Japan and China for about US 30 billion dollars respectively.

VI. Strategy for enhancing monetary and financial cooperation in East Asia

- Given the limited role and importance of ASEAN for representing ASEAN+3, it is expected that the future process of regional integration in Asia will be shaped in two stages, first by strengthening cooperation between +3 and secondly extending it to include ASEAN countries.
(Two track approach)
- Fortunately, the leaders of the +3 agreed to establish a Secretariat for the efficient promotion and management of trilateral cooperative projects, separately from the ASEAN+3 process.
- This will be the first crucial step towards the institutionalization of the partnership among the +3, which few believed possible.

- Some possible projects for the +3 countries.
- The swap between +3 (in parallel with the CMIM)
- The promotion of AMU as a divergence indicator and beyond, limiting the component national currencies to the currencies of +3 only.
 - Including all 13 nation's currencies in the basket could enhance the representativeness of the AMU. But at the same time it could mean adding currencies with low weight, increasing complexity and transaction costs tremendously. Especially, given that the economic and political disparities among ASEAN countries are so large that the conditions for the wide use of RCU are not mature enough.
 - Furthermore, there are already local currency swaps between Korean won and JY and between KRW and CY, which will help to solidify the use of the AMU composed of the currencies of +3.
- The common action for extra-regional monetary affairs.
- -For instance, +3 could announce jointly that they will support the purchase of European government bonds, especially Spanish government bonds, preventing the spread of euro crisis to the rest of the world.

Thank you