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South Korea and the Pitfalls of East Asian Monetary Regionalism: Do Neighbors Mean Neighborly Behavior?*

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In the aftermath of the Asian financial crisis, monetary regionalism has been widely advocated as a means to shelter East Asia from not only the volatility of global financial markets but also from the US-dominated International Monetary Fund. While the primary obstacle to deepening regional monetary cooperation centered around the Chiang Mai Initiative (CMI) is cogently identified as being political, the existing literature focuses mostly on the rivalry between the likely lenders, China and Japan, and neglects the likely borrowers. Using the case of South Korea, this paper provides a cautionary tale of the CMI from a borrower's perspective. Any workable liquidity-support arrangement, regional or otherwise, requires a robust surveillance mechanism to address the problem of moral hazard inherent to such a lending facility. In turn, an effective surveillance mechanism inevitably implies a significant political leverage for the lenders and vulnerability for the borrowers, an outcome that cannot be assumed to be avoidable by the CMI just by the virtue of its regional scope. There is little basis to expect that being neighbors necessarily means neighborly behavior; mere geographic proximity does not make China and Japan any less self-interested than the United States, nor does it make Korea's potential political costs more tolerable.

Key words: *East Asian regionalism, Chiang Mai Initiative, CMI multilateralization, South Korea.*

The wave of financial deregulation and liberalization that swept up South Korea (hereafter Korea) in the past two decades has turned what had once been one of the most repressed, closed, and tightly controlled financial systems in the world into one of the most liberal and open markets. Perhaps the most significant and

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disturbing consequence of the neoliberal transformation of the Korean financial system has been its heightened vulnerability to capital account shocks, illustrated most dramatically and painfully by the crisis of 1997 first, and then by another severe crisis in 2008 in the wake of the broader global financial meltdown triggered by the near-collapse of the US banking system. While the orthodox reading of the earlier crisis of 1997 heaped the blame on Korea's (in)famous developmental state and its many alleged sins, all but the most dogmatic neoliberal advocates of market fundamentalism now recognize that Korea's increased and repeated susceptibility to acute financial instability – indeed, of emerging market economies (EMEs) in general – has something to do with its aggressive pursuit of capital account liberalization and the accompanying, excessive exposure to highly unstable external capital flows. Liberalized partially in the early 1990s and completely swung open in the aftermath of the crisis of 1997 as part of the International Monetary Fund (IMF)-sponsored structural adjustment program, Korea's open capital account has been an invitation for its domestic financial institutions to indulge in excessive short-term external borrowing, and for foreign investors to channel hot money in and out of the country at whim. Both are clearly indicative of the Korean state's loss of its ability to act as the gatekeeper to international capital, a crucial role that it had played historically to not only weave together an effective web of industrial policies but also mediate between domestic and international financial markets and insulate the Korean financial system from adverse external shocks.

In the absence of any serious effort to reverse capital account liberalization, and facing dramatically increased exposure to external volatility and heightened fragility of the financial system, the Korean government has been going about in a costly search for an elusive solution to the problem of periodic and escalating instability that has been plaguing the global financial system. Policy-wise, this search has produced two concrete initiatives, both of which are focused on improving the asset side of Korea's international liquidity position, and neither of which can be said to have passed the test of the 2008 crisis in any meaningful sense: hoarding massive amounts of foreign exchange reserves as the first line of defense, and pursuing regional monetary cooperation to build an additional source of liquidity support. This article examines the limitations of the latter, specifically focusing on the Chiang Mai Initiative (CMI) and its recent multilateralization.

Much has been written about the CMI since its 2000 inception, and deservedly so, given the fact that it represents one of the most important and concerted efforts at institution-building in a region otherwise known for its relative lack of formalized multilateral cooperation. The challenges faced by regionalism in East Asia in general, proficiently outlined by numerous earlier studies, are old and familiar: lacking a common cultural framework and a shared political vision, regionalism in East Asia has been primarily market-driven rather than politically driven; consequently, its institutionalization has been shallow and the extent of its multilateralization has been limited; and there remain many economic and political obstacles that need to be overcome before East Asia can pursue a deeper, broader, and more institutionalized form of regionalism.[1] The CMI represents a potential break from these common clichés associated with East Asian regionalism, and thus to the optimistic proponents of greater regional cooperation, it may signal the coming of age for a region long known for deep-seated mutual distrust, seemingly unbreakable historical animosity, and smoldering political conflict and rivalry, all of which had made East Asia a laggard in regional integration.[2]

The emerging contours of monetary regionalism in East Asia, however, still remain shrouded in a cloud of uncertainty, and the recent multilateralization of the CMI, despite being hailed as a milestone event in some quarters, is yet to prove the ability of East Asia to provide a coherent regional solution to the problems generated by financial globalization.[3] Much of this skepticism rightly revolves around

1. Peter Katzenstein, "Introduction: Asian Regionalism in Comparative Perspective," in Peter Katzenstein and Takashi Shiraishi, eds., *Network Power: Japan and Asia* (Ithaca: Cornell University Press, 1997), pp. 1–44; Richard Stubbs, "Asia-Pacific Regionalization and the Global Economy: A Third Form of Capitalism?" *Asian Survey*, 35-9 (1995), pp. 785–797; Stephen Haggard, "Regionalism in Asia and the Americas," in Edward Mansfield and Helen Milner, eds., *The Political Economy of Regionalism* (New York: Columbia University Press, 1997), pp. 20–49; and more recently, Gilbert Rozman, *Northeast Asia's Stunted Regionalism: Bilateral Distrust in the Shadow of Globalization* (Cambridge: Cambridge University Press, 2005).

2. See, for instance, Hyoung-kyu Chey, "The Changing Political Dynamics of East Asian Financial Cooperation," *Asian Survey*, 49-3 (2009), pp. 450–467; Michael Green and Gill Bates, *Asia's New Regionalism: Cooperation, Competition, and the Search for Community* (New York: Columbia University Press, 2009); Richard Stubbs, "ASEAN Plus Three: Emerging East Asian Regionalism," *Asian Survey*, 42-3 (2002), pp. 440–455; Nick Bisley, "East Asia's Changing Regional Architecture: Towards an East Asian Economic Community?" *Pacific Affairs*, 80-4 (2007/2008), pp. 603–625; Ellen Frost, *Asia's New Regionalism* (Boulder: Lynne Reinner, 2008); Christopher Dent, *East Asian Multilateralism* (London: Routledge, 2008); Asian Development Bank (ADB), *Emerging Asian Regionalism: A Partnership for Shared Prosperity* (Manila: ADB, 2008). Interestingly, it is in monetary and financial affairs that East Asia has made the most tangible progress in terms of both the relative depth of institutionalization and extent of multilateralization. In matters of trade and cross-border investment, cooperation in the region has been pursued primarily through a patchwork of bilateral and sub-regional arrangements without any overarching multilateral framework, endorsing a "noodle bowl" approach. See Richard Baldwin, "Managing the Noodle Bowl: The Fragility of East Asian Regionalism," ADBI Working Paper Series on Regional Economic Integration, no. 7, February 2007; Mireya Solis and Saori Katada, "Understanding East Asian Cross-Regionalism: An Analytical Framework," *Pacific Affairs*, 80-2 (2007), pp. 229–57; and "Integrating Production," ADB, *op. cit.*, pp. 58–105.

3. For optimistic assessments, see Masahiro Kawai, "From the Chiang Mai Initiative to an Asian Monetary Fund," paper presented at the Conference on the Future Global Reserve System, Tokyo, 17–18 March 2010; Young-il Park, "Toward Regional Financial and Monetary Cooperation in East Asia," *Global Economic Review*, 32-4 (2003), pp. 51–44; Injoo Sohn, "East Asia's Counterweight Strategy: Asian Financial Cooperation and Evolving International Monetary Order," G-24 Discussion Paper 44, United Nations Conference on Trade and Development, Geneva (2007); and Yong Wook Lee, "Regional Financial Solidarity without the US: Contested Neoliberalism in East Asia," EAI Security Initiative Working Paper, no. 1 (September 2009). For a number of optimists, especially those in the economics profession, the final frontier and endgame of monetary regionalism is, not surprisingly but prematurely, a currency union. See Jong-Wha Lee, Yung Chul Park, and Kwanho Shin, "A Currency Union in East Asia," ISER Discussion Paper, no. 0571, March 2003; Nathalie

political obstacles, but the existing literature focuses mostly on great power politics – specifically, the absence of a clear regional hegemon and the rivalry between the likely lenders, China and Japan – and neglects the likely borrowers.[4] In this paper, I show that the difficulties of monetary regionalism in East Asia and the grounds for skepticism are not limited to just great power rivalry, important though it is. Using the case of Korea, I argue that the political implications of the CMI, taken to its logical end to meet its rationale – a credible regional liquidity-support mechanism that is politically autonomous from extra-regional actors – are equally if not more difficult for the likely borrowers, and accordingly, may not be relied upon as a viable, less costly alternative to the US-dominated IMF.

The premise of this skeptical prognosis is not based on any aspects that are necessarily unique to Korea or even East Asia in general. Rather, it is based on the very nature of any workable liquidity-support mechanism, regional or otherwise, which requires a robust surveillance mechanism to address the problem of moral hazard inherent to such a lending facility. An effective surveillance mechanism inevitably implies a significant political leverage for the lenders and vulnerability for the borrowers, and this is an outcome that cannot be assumed to be avoidable by the CMI just by the virtue of its regional scope, *if* it is to fulfill its role effectively. There is little basis to expect that being neighbors necessarily means neighborly behavior. Mere geographic proximity, *ipso facto*, does not make China and Japan any more generous and less self-interested than the United States, nor does the exclusively regional scope of the CMI make Korea's potential political costs any less onerous and more tolerable than the strings attached by the IMF.

This article is structured into three main parts. The first section gives an overview of the origins and development of the CMI from its 2000 inception to its multilateralization in 2010, focusing on the rationale behind its creation and its limits and situating it in the context of Korea's increasing vulnerability to capital account shocks. The second section examines the multilateralization of the CMI (CMIM), improvements made thereof, and its continuing limits. In the third section, I discuss the weakest link in the CMI, its inadequate surveillance mechanism, as the key obstacle to the evolution of the CMI into an Asian Monetary Fund (AMF), and why its strengthening presents a difficult dilemma for potential borrowers, such as Korea.

Aminian, "Economic Integration and Prospects for Regional Monetary Cooperation in East Asia," *Structural Change and Economic Dynamics*, 16 (2005), pp. 91–110; Yeongseop Rhee, "East Asian Monetary Integration: Destined to Fail?" *Social Science Japan Journal*, 7-1 (2004), pp. 83–102; and David Kim, "An East Asian Currency Union? The Empirical Nature of Macroeconomic Shocks in East Asia," *Journal of Asian Economics*, 18-6 (2007), pp. 847–66.

4. See William Grimes, *Currency and Contest in East Asia: The Great Power Politics of Financial Regionalism* (Ithaca: Cornell University Press, 2008); William Grimes, "The Asian Monetary Fund Reborn? Implications of Chiang Mai Initiative Multilateralization," *Asian Policy*, 11 (2011), pp. 79–104; Wen Jin Yuan and Melissa Murphy, "Regional Monetary Cooperation in East Asia: Should the US Be Concerned?" Center for Strategic and International Studies (7 November 2010).

Origins of the CMI and Korea's Financial Vulnerability: A Regional Solution to a Global Problem?

While East Asia's pursuit of the CMI has a clear economic rationale – to provide a regional source of liquidity support in times of financial instability – it is as much a political project as an economic undertaking, in that from the very beginning the CMI was motivated by the region's desire to find a counterweight to the IMF and its dominant shareholder, the United States. As is widely known, the origins of the CMI are located firmly in the Asian financial crisis and the painful lessons emanating from the crisis, which, among others, underscored the extent of East Asia's vulnerability in the face of financial globalization, exposed its impotence to offer any regional solutions, and generated what one observer called "the politics of resentment" in the region to serve as the catalyst for the initiative.[5] It is in fact a follow-up to the earlier, ill-fated Japanese proposal for the AMF in 1997, a regional mechanism of financial stabilization that, had fate unfolded differently, would have provided large-scale liquidity to crisis-afflicted countries drawing from a fund of up to $US100bn, half of which would have come from the Japanese. Of course, the AMF quickly fell victim to geopolitics and institutional resistance, facing fierce opposition from three key actors: the United States, which saw the AMF as a threat to its influence in the region; the Chinese, who were reluctant to endorse what they perceived to be Japan's attempt to assert itself as a regional economic hegemon; and less importantly, the IMF as well, which for institutional and bureaucratic reasons also saw the AMF as a threat intruding onto its own turf.[6]

As a second-best alternative to the AMF, the CMI was "of the same philosophy as the AMF" as described by the then Japanese Finance Minster Kiichi Miyazawa, but it was also a much watered-down version with extremely modest aims.[7] The arrangement allowed the ASEAN Plus Three (APT) countries to revisit the conceptual basis of the AMF without triggering too many alarm bells in Washington, one that was sufficiently diluted so as not to elicit hostile opposition from the United States and the IMF while assuaging the Chinese suspicion over the Japanese intent. Accordingly, the CMI in its initial form came nowhere close to resembling the sort of multilateral regional institution embodied by the moribund

5. Richard Higgot, "The Asian Economic Crisis: A Study in the Politics of Resentment," *New Political Economy*, 3-3 (1998), pp. 333–356. See also John Ravenhill, "A Three Bloc World? The New East Asian Regionalism," *International Relations of the Asia Pacific*, 2-2 (2002), pp. 167–195; Rodney Hall, "The Discursive Demolition of the Asian Development Model in the Asian Financial Crisis," *International Studies Quarterly*, 47-1 (2004), pp. 71–99; and Injoo Sohn, "Asian Financial Cooperation: The Problem of Legitimacy in Global Financial Governance," *Global Governance*, 11-4 (2005), pp. 487–504.
6. On the politics of the AMF proposal, see Yong Wook Lee, "Japan and the Asian Monetary Fund: An Identity-Intention Approach," *International Studies Quarterly*, 50-2 (2006), pp. 339–66; Paul Blustein, *The Chastening: Inside the Crisis That Rocked the Global Financial System and Humbled the IMF* (New York: PublicAffairs, 2001), pp. 162–170.
7. Quoted in Hyoung-kyu Chey, *op. cit.*, p. 460.

AMF. It was a bare-bone arrangement composed of nothing but a simple network of bilateral swap agreements (BSAs) reached among the APT countries. Not only was the CMI no more than a collection of BSAs, the amount disposable under the scheme was miniscule at best ($US36.5bn in total initially); and even this extremely modest sum could not be accessed fully unless the requesting country first concluded an agreement with the IMF. The so-called "IMF link" allowed the participating countries to tap only 10% of their BSAs without the vetting of the Fund. Moreover, there was no guarantee that the money would actually be there when needed, as an opt-out arrangement had made the activation of the BSAs contingent on the willingness of the potential lenders, and thus the BSAs ultimately unenforceable. Nor was there a viable surveillance mechanism, crucial to addressing the problem of moral hazard lurking around any liquidity assistance scheme. While commitments were made and repeated on numerous occasions to build the APT's surveillance capacity, the only result, a very modest one at that, was Economic Review and Policy Dialogue (ERPD), a vague process involving informal exchange of information, nebulous policy dialogue, and non-binding, hazy peer reviews without any enforcement mechanism.

About the only thing the CMI achieved was the exclusion of the United States as the APT managed to limit membership to the region. On the surface, this may seem as though the politics of resentment was the most consequential lesson from the Asian financial crisis, propelling East Asian countries to make the exclusion of the United States the focal point of their cooperative effort.[8] Yet, unlike the ill-fated AMF, the CMI was not opposed by the United States. The reason was simple: it posed no threat to US interests in the region. The lack of US resistance to the CMI was less an indicator of the mellowed position of Washington than the sheer distance by which the CMI fell short of the AMF. In particular, the IMF link meant that while Washington was kept out of the arrangement, it was not left out of the loop.

While a series of additional steps was taken to strengthen the CMI, none of them made it any more credible or even that useful for the potential borrowers. For instance, the BSAs were expanded several times to eventually reach a total of around $US90bn by 2008, and the amount of disposable resources without the vetting of the IMF was increased to 20% in May 2005. The APT also incorporated the ERPD into the CMI framework, making any release of fund conditional on participation in the ERPD process, which was accompanied by the adoption of a collective decision-making procedure for the CMI activation as an initial step

8. As Euiseke Sakakibara, former deputy finance minister of Japan who spearheaded the AMF proposal, stated bluntly, "If East Asia does not want to be divided and ruled as in the colonial days and in the more recent past, we need to form some types of regional cooperation of our own." Quoted in Yong Wook Lee, "Regional Financial Solidarity without the US," *op. cit.*, p. 12. See also Injoo Sohn, "East Asia's Counterweight Strategy," *op. cit.*; and Paul Bowles, "Asia's Post-Crisis Regionalism: Bringing the State Back in, Keeping the (United) States Out," *Review of International Political Economy*, 9-2 (2002), pp. 240–270.

toward eventual multilateralization of the CMI.[9] However, very little came of the attempt to strengthen the surveillance capacity of the APT, while the increase in the BSAs merely took the level of the available resources from being totally inadequate to highly inadequate, whose usefulness was further undermined by the continuing placement of the IMF link on 80% of the funding. The CMI in its initial stage therefore could satisfy neither the economic motivation nor the political desire of the APT in pushing toward greater monetary cooperation. On the economic side, the size of the disposable resources was simply too small and their disbursement too uncertain for the CMI to be counted as a reliable and credible source of liquidity relief. Politically, the IMF link made the arrangement contingent on the countenance of the Fund and, by extension, the United States. The CMI was thus nowhere close to making East Asia more resilient to financial shocks or more politically independent from the United States.

While the lackluster development of the CMI belied the rhetoric behind it, the region's risk-exposure to capital account shocks kept growing substantively and rapidly, largely as a result of the near complete opening of capital markets imposed by the IMF in the aftermath of the crisis of 1997. In the case of Korea, whatever restrictions on cross-border capital flows that had still remained prior to 1997 were thrown out the window, and this was soon followed by a torrential inflow of short-term, flight-prone capital – first in the form of foreign portfolio investment (FPI), and then a resumed mushrooming of the banking sector's short-term external liabilities, both of which exposed Korea to the same vulnerability to a sudden swing in capital flows that had led to the crisis of 1997.

The rapid buildup in Korea's vulnerability to capital account shocks since 1997 to the eve of the global financial crisis of 2008 is shown in Tables 1 and 2, which

Table 1. *Foreign Portfolio Investment in Korea: Flow and Stock, 1997–2007 (Billions of $US)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Flow											
Total	13.3	0.8	7.9	12.7	12.2	5.4	22.7	18.4	14.1	8.1	30.4
Equity	2.5	3.9	12.1	13.1	10.3	0.4	14.4	9.5	3.3	–8.4	–28.7
Debt securities	10.8	–3.1	–4.2	–0.4	2.0	5.0	8.3	8.9	10.8	16.4	59.1
Stock											
Total	60.2	65.7	107.2	80.3	106.4	116.2	165.0	210.3	310.5	352.4	456.7
Equity	6.2	18.7	62.9	40.5	70.0	75.7	116.8	156.4	249.5	276.4	320.1
Debt securities	54.1	47.0	44.3	39.9	36.4	40.5	48.3	53.9	61.0	76.0	136.6

Source: Bank of Korea, *Economic Statistics System*.

9. APT, "Joint Ministerial Statement of the 8th ASEAN+3 Finance Ministers' Meeting," Istanbul, Turkey (4 May 2005), at <http://www.mof.go.jp/english/international_policy/convention/asean_plus_3/20050504.htm> (searched date: 24 February 2014).

***Table 2.** External Debts of Korea, 1997–2007 (Billons of $US)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total	167.3	155.5	144.8	141.4	121.3	132.8	141.7	150.6	161.4	225.2	333.4
Long-term	103.5	115.9	101.7	91.8	81.1	84.6	90.8	94.3	95.5	111.5	173.2
Short-term	63.8	39.6	43.1	49.7	40.3	48.2	50.8	56.3	65.9	113.7	160.2
Short-term (% of total)	38.1	25.5	29.7	35.1	33.2	36.3	35.9	37.4	40.8	50.5	48.1

Source: Bank of Korea, *Economic Statistics System.*

summarize, respectively, the flow and stock of FPI in Korea and its external debts. As shown, the influx of FPI increased sharply over the period, surging from just $US0.8bn in 1998 to a peak of $US22.7bn in 2003; by 2007, a cumulative amount of $US132.7bn had come into Korea as FPI, with its outstanding stock rising from $US65.7bn in 1998 to $US456.7bn in 2007. Korea's external liabilities also ballooned again not too long after its financial institutions regained their access to international capital markets, with a renewed appetite for short-term borrowing that, by the mid-2000s, had turned into a binge: the external liabilities of Korea rose dramatically from the low of $US121.3bn in 2001 to $US333.4bn in 2007; short-term liabilities jumped fourfold from $US40.3bn to $US160.2bn over the same period; and as a result, the share of short-term liabilities, the key source of instability in 1997, climbed up steadily to reach over half of the outstanding external liabilities by 2006.[10] The cumulative consequence of these developments was not only a large, accelerating buildup of Korea's external financial liabilities, but one that had a pronounced tendency to gravitate toward short-term, highly liquid and potentially unstable types of capital flows: from $US105.3bn in 1998, the stock of hot money in Korea had doubled to $US215.8bn by 2003, and then nearly tripled from this to $US616.9bn by 2007 (see Table 3).

Given the sheer scale of the logjam of hot money sitting atop Korea, and the severely curtailed funding capacity of the CMI, it should hardly come as a surprise that the CMI was completely bypassed in 2008 when the near-collapse of the US banking system ushered in the worst global economic crisis since the Great Depression. While the fallout from the US banking crisis was global in scope, it

10. The Korean banking sector as a whole has always had a propensity to rely disproportionately on short-term external loans. Even at its lowest point in 1998, the banking sector's share of short-term foreign debts was still around 43% of total external liabilities, and in the post-recovery period, ranged from 60 to 70%. A large part of this bias for short-term liabilities is actually explained by the domestic branches of foreign banks operating in Korea rather than Korean banks themselves. These branches have always had a natural tendency to raise short-term funds cheaply from their parent banks as an easy way to churn out lucrative profits in Korea's financial markets through interest-rate arbitrage. The share of their short-term borrowing never dipped below 85% of their total external borrowing, and after the 1997 crisis, this bias actually became even more pronounced with almost all of their external liabilities, over 95% in 2006, having a short-term maturity. BOK, *Economic Statistics System*, database online, at <ecos.bok.or.kr/EIndex_en.jsp>.

Table 3. *Stock of Flight-prone Foreign Capital in Korea, 1997–2007 (Billion of $US)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Short-term debts	63.8	39.6	43.1	49.7	40.3	48.2	50.8	56.3	65.9	113.7	160.2
Foreign portfolio investment	60.2	65.7	107.2	80.3	106.4	116.2	165.0	210.3	310.5	352.4	456.7
Total	124.0	105.3	150.3	130.0	146.7	164.4	215.8	266.6	376.4	466.1	616.9

Source: Bank of Korea, *Economic Statistics System*.

was especially swift and severe for EMEs. Korea in particular was hit very hard by the onset of a severe credit crunch, conditions of which came very close to approximating those of the 1997 crisis: a massive exodus of foreign capital, an intense pressure on its currency, and rapid depletion of foreign exchange reserves. Yet, rather than turning to the CMI, Korea turned to the United States for assistance by asking for and drawing from a $US30bn emergency swap facility with the US Federal Reserve Board, even though the explicitly intended economic purpose of the CMI was to provide liquidity relief precisely under such circumstances while its political rationale was to bypass the United States.[11] Indeed, as a Bank of Korea (BOK) official noted with sarcasm, the CMI was all "word" and no action, and it was, at least in 2008, in no shape to be taken as a credible source of liquidity support.[12] Korea was not alone in bypassing the CMI, moreover; in fact, the CMI remained dormant the whole time. That none of the participating countries in the scheme turned to the CMI at the most apropos time and for the exact purpose for which it was created says something profoundly meaningful about the actual state of East Asian monetary and financial cooperation behind the rhetoric. That Korea turned to the United States says something even more significant about the sheer failure of the CMI to meet its political objective.

CMI Multilateralization: Improvements and Persistent Limits

Recognizing the limits of the CMI, especially in light of its irrelevance during the crisis of 2008, regional actors made greater efforts to strengthen the arrangement,

11. For an overview of Asian countries' policy response to the 2008 global economic crisis, see Masahiro Kawai, Mario Lamberte, and Yung Chul Park, eds., *The Global Financial Crisis and Asia: Implications and Challenges* (Oxford: Oxford University Press, 2012). On the crisis' implications for the region's financial cooperation, see William Grimes, "The Global Financial Crisis and East Asia: Testing the Regional Financial Architecture," EAI Working Paper Series, no. 20 (June 2009); William Grimes, "The Future of Regional Liquidity Arrangements in East Asia: Lessons from the Global Financial Crisis," *Pacific Review*, 24-3 (2011), pp. 291–310; Masahiro Kawai, "Reform of the International Financial Architecture: An Asian Perspective," ADBI Working Paper, no. 167 (November 2009).
12. Anonymous interview, Bank of Korea, Seoul (6 June 2012).

which finally brought about its long-discussed multilateralization in 2010. Commitments to multilateralizing the CMI had been made in principle as early as 2005, but the actual progress had been rather slow with the negotiations bogging down over specific elements of implementation, particularly over contribution quotas. The bone of contention was essentially fought between China and Japan. Unlike the member states of ASEAN, which were able to quickly reach an agreement on their individual shares among themselves, China, Japan, and to a lesser extent Korea as well, engaged in rather protracted and testy negotiations. On the one hand, the Japanese insisted that they should be the largest contributor to the CMIM, on the basis of the fact that that their economy was then the largest in the region and their contribution to the CMI was also the largest. The Chinese, on the other hand, found this unacceptable – hardly surprising given their earlier rejection of the Japanese-led AMF – and maintained that their share should be at least equal to that of the Japanese, given the fact that China was the largest holder of foreign currency reserves in the world and its economy was on a clear trajectory to overtake the Japanese economy soon, as it in fact did in 2010.[13] This Sino–Japanese dispute was the key roadblock to multilateralization, and surmounting this obstacle did not come about until the outbreak of the financial upheaval triggered by the bankruptcy of Lehman Brothers and the subsequent global economic crisis hastened the need for resolving their differences.

In what has been described as an ingenious compromise in some quarters, both China and Japan were able to claim victory in the final outcome. As it wished, Japan received the largest contribution quota at 32% of the total pool, while China's share was set at 28.5%. However, Hong Kong was added as a new participant in the scheme and was given a share of 3.5%, and as a result the overall share of Chinese contribution increased to 32%, exactly the same as the Japanese share. With the biggest obstacle to multilateralization removed with this scheme, the APT was finally able to transform networks of simple BSAs into a self-managed reserve pool. In addition, it also increased the size of the fund from $US90bn to $US120bn, which was subsequently doubled to $US240bn in 2012, and expanded the number of participants as well to include all members of ASEAN, bringing CMIM membership in line with APT membership.[14]

In terms of the modality over contribution shares, borrowing quotas, and voting weight, the arrangement of the CMIM somewhat mirrors that of the IMF (see Table 4). The overall ratio of contributions between ASEAN and the Plus Three countries is set at 2:8, with the latter committing $US192bn and the rest coming from the ASEAN members. Reflecting a different likelihood of and vulnerability to a liquidity crisis among the participating members, borrowing quotas are set as multiples of contributions in an inverse relationship to their size – that is, the

13. Masahiro Kawai, "Reform of the International Financial Architecture," *op. cit.*; see also William Grimes, "The Asian Monetary Fund Reborn?" *op. cit.*, pp. 95–96.

14. The five countries that had previously not participated in the CMI – Brunei, Cambodia, Lao, Myanmar and Vietnam – are now part of the reserve pool.

Table 4. *CMIM Contributions, Borrowing Quotas, and Voting Weights*

	Contribution						
	$US (billions)		**Share (%)**		**Purchasing multiple**	**Voting weight (%)**	
China	76.8	China, excluding Hong Kong: 68.4	32.0	28.5	0.5	28.41	25.43
		Hong Kong: 8.4		3.5	2.5		2.98
Japan	76.8		32.0		0.5	28.41	
Korea	38.4		16.0		1	14.77	
Plus 3 subtotal	192.0		80.0		–	71.59	
Indonesia	9.104		3.793		2.5	4.369	
Thailand	9.104		3.793		2.5	4.369	
Malaysia	9.104		3.793		2.5	4.369	
Singapore	9.104		3.793		2.5	4.369	
Philippines	9.104		3.793		2.5	4.369	
Vietnam	2.0		0.833		5	1.847	
Cambodia	0.24		0.100		5	1.222	
Myanmar	0.12		0.050		5	1.179	
Brunei	0.06		0.025		5	1.158	
Lao	0.06		0.025		5	1.158	
ASEAN subtotal	48.0		20.00		–	28.41	
Total	240.0						

Source: ASEAN Plus Three, "Joint Ministerial Statement of the 13th ASEAN+3 Finance Ministers' Meeting," 2 May 2010, Tashkent, Uzbekistan, <http://www.asean.org/archive/documents/JMS_13th_AFMM+3.pdf>; ASEAN Plus Three, "Joint Ministerial Statement of the 15th ASEAN+3 Finance Ministers' Meeting," 3 May 2012, Manila, the Philippines, <http://www.amro-asia.org/wp-content/uploads/2012/05/120503AFMGM+3-JS.pdf>.

CMIM, Chiang Mai Initiative multilateralization.

ASEAN members making smaller contributions have higher purchasing multiples, while Korea's limit is set at parity with its contribution and China and Japan, reflecting their lender status, have access to only half their contributions. The voting system is a weighted one, much as is the case at the IMF. Every participating member except Hong Kong has a small number of equal basic votes (14.8% of the total), and the remainder of the votes is based on the level of contribution.

Decision-making follows a two-tier system. At the ministerial level, consisting of APT finance ministers initially and then of central bankers as well beginning in 2013, a consensus approval is required to decide on "fundamental issues," such as the review of the total size of CMIM, contribution, and borrowing multiples, as well as readmission, membership, and terms of lending. "Executive level issues," including initial execution of drawing, renewal, and default, are determined by a two-thirds majority at the deputy-level, comprised of deputy representatives from the APT's finance ministries and central banks.[15]

15. APT, "Joint Ministerial Statement of the 13th ASEAN+3 Finance Ministers' Meeting" (2 May 2010), Tashkent, Uzbekistan, at <http://www.asean.org/archive/documents/JMS_13th_AFMM+3.pdf> (searched date: 24 February 2014).

In addition, the APT has also sought to address the perennial problem surrounding its lack of credible and robust surveillance capacity by further enhancing the ERPD process and, more importantly, creating an independent regional macroeconomic surveillance unit called the ASEAN+3 Macroeconomic Research Office (AMRO). Located in Singapore and operating since 2011, AMRO is "to monitor and analyze regional economies, which contributes to the early detection of risks, swift implementation of remedial actions, and effective decision-making of the CMIM."[16]

Clearly, all of these changes improve upon the previous CMI. Despite this progress, however, it is also clear that CMIM still remains unable to satisfy the two core motivations that have sustained East Asia's decade-long drive toward greater regional monetary and financial cooperation: it answers neither the economic desire for "self-help and support mechanisms" nor the political desire to attain them on an exclusively regional basis.

While $US240bn is a large number, it is nonetheless dwarfed by the massive size of foreign exchange reserves collectively held by the APT countries. East Asian countries, along with nearly every other EME and developing country elsewhere, have been accumulating huge amounts of reserves since the crisis of 1997 as a precautionary measure to insure themselves against the volatility of global financial markets.[17] The APT members together hold well over a whopping $US6.1 trillion in foreign exchange reserves now; next to this number, even $US240bn looks very small, accounting for only 3.9% of the total reserves held by the participating economies of the CMIM. Individual contributions are also miniscule relative to each member's reserve holdings, ranging from a low of 2% for China and a high of 11.8% for Korea (see Table 5).

More problematically, the actual size of the available funding for potential borrowers falls far short of what would justify calling CMIM a genuine regional self-help mechanism able "to address short-term liquidity difficulties in the region," one of the key objectives repeatedly emphasized by the APT. In the case of Korea, under the initial terms of the CMIM it could draw up to just $US19.2bn. This was doubled to $US38.4bn in 2012, but the enlarged access still remains significantly smaller than the size of the rescue package Korea received in 1997, which amounted to $US58.4bn. Adjusted for inflation, the total financing available to Korea through CMIM is less than half of its IMF-led financing (see Table 6).

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16. *Ibid*.

17. On reserve accumulation in the developing world, see Graham Bird and Ramkishen Rajan, "Too Much of a Good Thing? The Adequacy of International Reserves in the Aftermath of Crises," *World Economy*, 26-6 (2003), pp. 873–891; Graham Bird and Alex Mandilaras, "Reserve Accumulation in Asia: Lessons for Holistic Reform of the International Monetary System," *World Economics*, 6-1 (2005), pp. 85–99; Dani Rodrik, "The Social Cost of Foreign Exchange Reserves," *International Economic Journal*, 20-3 (2006), pp. 253–266; Jose Antonio Ocampo, "The Instability and Inequities of Global Reserve System," UN/DESA Working Paper, no. 59 (November 2007).

Table 5. *CMIM Contributions and Reserve Holdings of Participating Countries, as of 2013 (Billions of $US Unless Otherwise Noted)*

		CMIM contribution	
	Reserve holdings	**Amount**	**Percentage of reserves**
China, including Hong Kong	3,819.3	76.8	2.0
Japan	1,238.7	76.8	6.2
Korea	326.4	38.4	11.8
Indonesia	98.1	9.104	9.3
Thailand	170.8	9.104	5.3
Malaysia	136.1	9.104	6.7
Singapore	259.8	9.104	3.5
Philippines	84.0	9.104	10.8
Total	6,133.2	240.0*	3.9

Source: International Monetary Fund, *International Financial Statistics*.
* Includes the quota of $US2.48bn for news members added with multilateralization.
CMIM, Chiang Mai Initiative multilateralization.

Table 6. *Current CMIM Borrowing Quota in Comparison to the IMF-led Financing in 1997, Inflation-adjusted (Billions of $US Unless Otherwise Noted)*

1997 support package (A)	58.4
Eligible CMIM financing	
With IMF-link:	
Amount (B)	38.4
% of A, inflation-adjusted	48.9
Without IMF-link:	
Amount (30% of B)	11.52
% of A, inflation-adjusted	14.7

Source: ASEAN Plus Three, "Joint Ministerial Statement of the 13th ASEAN+3 Finance Ministers' Meeting," 2 May 2010, Tashkent, Uzbekistan, <http://www.asean.org/archive/documents/JMS_13th_AFMM+3.pdf>; ASEAN Plus Three, "Joint Ministerial Statement of the 15th ASEAN+3 Finance Ministers' Meeting," 3 May 2012, Manila, the Philippines, <http://www.amro-asia.org/wp-content/uploads/2012/05/120503AFMGM+3-JS.pdf>.
CMIM, Chiang Mai Initiative multilateralization.

While the limited size of the CMIM's reserve pool is problematic, it is probably the easiest problem to address. Given the huge size of reserves held by the APT members, especially by the two largest potential lenders, increasing the funding capacity of the CMIM should not be that difficult, as shown by the relative ease with which the reserve pool was doubled to $US240bn in 2012. More problematic is the IMF link, which has not been removed by multilateralization. Although the amount of delinked fund was increased to 30% in 2012 and may potentially be further increased to 40% in 2014 subject to review, the majority of CMIM resources are still tied to the IMF. With 70% of CMIM funding still requiring the vetting of the IMF, its already limited financing capacity is reduced rather drastically. Since Korea's purchase parity is one, in effect it has link-free access to only 30% of its quota, able to access just $US11.5bn from CMIM before the IMF link kicks in – only 14.7% of the 1997 rescue package after adjusting for inflation (see Table 6).

To see the inadequacy of the delinked funding capacity from another angle, consider what Korea faced during the crisis of 2008: foreign investors and creditors yanked nearly $US75bn out of the country (see Table 7 for details), forcing the BOK to burn through $US64bn in futile foreign exchange interventions until it got hold of the lifeline thrown by the US Federal Reserve Board. Adjusted for inflation, $US11.5bn in Korea's link-free access to CMIM amounts to just 17.4% of the capital exodus and 14.4% of the BOK's currency market intervention over the course of the 2008 crisis (see Table 8).

Given the fact that capital inflows to the region expanded dramatically from 1997 and have continued to do so since 2008, a more appropriate benchmark to gauge the adequacy of CMIM funding capacity is the current size of potential capital drainage. In the case of Korea, whose banking sector could not be weaned off its reliance on short-term loans even after two crises and whose financial markets have been penetrated by foreign capital to a historically unprecedented level with few contemporary parallels, $US11.5bn provides hardly any cushion at all. As of the end of 2012, even after winding down its short-term liabilities substantially since the liquidity crisis of 2008, Korea still owed $US126.8bn in short-term debt, and the stock of foreign-owned equity investment amounted to $US363.4bn while that of debt securities amounted to $US218.9bn, for a total of $US709.1bn in exposure to potentially volatile forms of foreign capital. Of course,

Table 7. *Foreign Capital Drain by Month, July 2008–March 2009 (Billions of $US)*

	2008						2009			
	Jul.	**Aug.**	**Sep.**	**Oct.**	**Nov.**	**Dec.**	**Jan.**	**Feb.**	**Mar.**	**Total**
Foreign portfolio investment										
Equity	–4.3	–2.6	–3.1	–4.0	–1.5	1.2	0.1	–0.7	1.3	–13.5
Debt Securities	–3.7	1.4	–2.8	–4.7	–4.8	–1.2	3.6	–0.7	–3.7	–16.5
Subtotal (A)	–8.0	–1.2	–5.9	–8.7	–6.3	0.0	3.7	–1.3	–2.4	–30.1
Bank loans										
Long-term	0.2	–0.9	–0.5	0.3	0.7	–0.4	0.2	0.2	–0.1	–0.2
Short-term	4.8	6.8	–1.2	–18.8	–10.9	–17.9	–7.6	–0.9	1.0	–44.6
Subtotal (B)	5.0	5.9	–1.7	–18.5	–10.2	–18.2	–7.4	–0.7	0.9	–44.8
Total drain (A + B)	–3.0	4.7	–7.6	–27.1	–16.4	–18.2	–3.7	–2.0	–1.5	–74.9

Source: Bank of Korea, *Economic Statistics System.*

Table 8. *Current CMIM Borrowing Quota Relative to Foreign Capital Drain and Reserve Loss in 2008, Inflation-adjusted (Billions of $US Unless Otherwise Noted)*

		Coverage ratio of borrowing quota, inflation-adjusted (%)	
		With IMF-link	**Without IMF-link**
Foreign capital drain, July 2008–March 2009			
Bank loans	44.8	80.1	24.0
Foreign portfolio investment	30.1	119.2	35.8
Total capital drain	74.9	47.9	14.4
Reserve drain, peak to trough	64.0	56.1	16.8

Source: Bank of Korea, *Economic Statistics System*.
CMIM, Chiang Mai Initiative multilateralization; IMF, International Monetary Fund.

Table 9. *Sources of External Capital Drain and CMIM Funding Capacity for Korea, as of the End of 2012 (Billions of $US Unless Otherwise Noted)*

		Coverage ratio of borrowing quota (%)	
		With IMF-link	**Without IMF-link**
Short-term external debt (A)	126.8	30.3	9.1
FPI stock: equity	363.4	10.6	3.2
FPI stock: debt securities	218.9	17.5	5.3
Total	709.1	5.4	1.6
30% of FPI (B)	174.69	22.0	6.6
Total potential capital drain (A + B)	301.49	12.7	3.8

Source: Bank of Korea, *Economic Statistics System*.
CMIM, Chiang Mai Initiative multilateralization; FPI, foreign portfolio investment; IMF, International Monetary Fund.

it is not reasonable to assume that all of this money would leave at once, but it is not a leap of imagination to surmise that $US11.5bn does not really give much breathing room against this kind of exposure. Using a conservative estimate of 30% to measure the size of prospective capital flight via FPI, and the standard practice of earmarking the full amount of short-term liabilities as flight-prone capital, the size of potential capital drain comes to $US301.5bn, over 27 times larger than Korea's delinked borrowing quota under the CMIM (see Table 9 for details). Clearly, without further expanding the reserve pool and, much more importantly, removing the IMF link, the CMIM cannot really function as a "self-help" mechanism of regional liquidity support.

This inability of the CMI in its present form to deliver on its economic objective of addressing liquidity problems in the region is closely tied with its failure to deliver on its political objective of finding a purely regional solution. The maintenance of the IMF link not only negates the role of the CMI as a significant source of financing, but it also denies the regional autonomy craved by the proponents of East Asian regionalism as the United States still remains very much in the loop via its control of the Fund. Thus, while multilateralization does take the CMI one step closer to the AMF, it is nonetheless only a very small step.

CMI and the Problem of Surveillance: Kinder and Gentler?

The limits of the CMI are the consequences of the underlying political tensions that were never really resolved but only skirted off, to give the appearance of a cooperative initiative supported not only by regional actors but also the United States. Crucial in this respect is the lack of a robust surveillance mechanism, the weakest link in the CMI that explains its subordination to the IMF as a second fiddle and, by extension, the United States. It is also a problem that has not been fully addressed by the multilateralization of the CMI.

For the CMI to meet its economic objective of providing effective liquidity support to its participants and the political objective of achieving this without needing the countenance of the United States, there is no question that the IMF link must be removed. This, however, is a far bigger problem than simply increasing the size of the reserve pool, as the CMI still lacks a credible surveillance mechanism, which is indispensable to removing the IMF link. By its very nature, every liquidity support system inherently faces the potential problem of moral hazard. From the lenders' perspective, there must be some way to enforce conditionality *ex ante* and *ex post* to ensure that the CMI funding does not turn into a spigot of easy money for countries facing economic difficulties of their own making, and, most importantly, the lenders are paid back.[18] This requires a broad agreement on a concrete set of rules defining acceptable standards of economic management, lending and disbursement criteria, serious peer review, and commitment to enforce these rules. Put differently, a credible surveillance mechanism must do all the things that the IMF does through its Article IV consultation and conditionality; and these go well beyond the pleasantries of informal policy dialogues and exchange of information characterizing the ERPD process.

While the multilateralization of the CMI was accompanied by the creation of a new regional surveillance unit, it is not clear yet how much competence the APT

18. See William Grimes, "The Asian Monetary Fund Reborn?" *op. cit.*, pp. 96–98. See also Soyoung Kim and Doo Yong Yang, "Financial and Monetary Cooperation in East Asia: Challenges after the Global Financial Crisis," *International Economic Journal*, 25-4 (2011), pp. 582–584; Jee-Young Jung, "Regional Financial Cooperation in Asia: Challenges and Path to Development," BIS Papers, no. 42 (2008); Masahiro Kawai and Cindy Houser, "Evolving ASEAN+3 EPRD: Towards Peer Review or Due Diligence," ADBI Discussion Paper, no. 79 (2007).

is willing to vest in the AMRO. On the surface, the AMRO is entrusted with the task of monitoring, assessing, and reporting on the macroeconomic situation and financial soundness of the APT countries; assessing macroeconomic and financial vulnerabilities of the member countries and formulating timely policy recommendations to mitigate such risks; and ensuring compliance of borrowing countries with the terms of financing.[19] Exactly in what concrete ways these tasks will be carried out remains to be seen though, especially when it comes to conditionality – in essence, there really is no way to find out unless and until the CMI is activated.

At its core, the lack of an effective surveillance mechanism and uncertainty over its future development are political problems, running on at least three axes: between the regional actors and the United States; between China and Japan; and between the likely lenders and borrowers. The first two political problems are as old as the CMI and familiar. On the question of the United States, it is not clear at all that the United States would stand by idly even if the APT were to move seriously toward its own separate surveillance mechanism and the eventual removal of the IMF-link. Thus far, the United States has not openly opposed the CMI and its multilateralization precisely because of all the limitations discussed above, particularly the IMF-link that subordinates the CMI to the Fund and consequently enables Washington to exercise indirect veto power over 70% of CMI funding without contributing a single cent. The United States may start singing a different tune if the loops are really about to be closed on it.

Second, under the current structure, the CMI has neither a clear leader nor a clear condominium, but two rivals in an awkward partnership. The sleight of hand that enabled both China and Japan to emerge smiling from tough negotiations over contribution shares may actually reduce the capacity of the CMI to generate a coherent institutional grammar to build a robust surveillance mechanism, without which de-linking from the IMF cannot be pursued. Rules are adopted and enforced so much more easily when there is a hegemon – to paraphrase Charles Kindleberger's seminal work, "for the [regional] economy to be stabilized, there has to be a stabilizer, one stabilizer."[20] Neither China nor Japan can claim this role in the region. In the absence of a clear leader, a partnership of equals based on mutual trust, something along the line of the Franco–German partnership in Europe, may be the second-best shot. But here again, Sino–Japanese relations are not exactly on the same footing as Franco–German relations.[21] Given the fact that

19. For a recent discussion of the AMRO, see Reza Siregar and Akkharaphol Chabchitrchaidol, "Enhancing the Effectiveness of CMIM and AMRO: Selected Immediate Challenges and Tasks," ADBI Working Paper Series no. 403 (January 2013).
20. Charles Kindleberger, *The World in Depression, 1929–1939* (Berkeley: University of California Press, 1973), p. 304.
21. See William Grimes, *Currency and Contest in East Asia*, *op. cit.*; Benjamin Cohen, "Finance and Security in East Asia," paper presented at the Conference on the Political Economy of National Security in East Asia, Beijing (July 2010); Richard Samuels, *Securing Japan: Tokyo's Grand Strategy and the Future of East Asia* (Ithaca: Cornell University Press, 2007).

surveillance and enforcement require politically costly and difficult decisions from the lenders, China and Japan need the assurance that they can count on each other to stick to their guns to enforce unpleasant conditionality. It is by no means clear that the two countries can have this kind of mutual trust. As Grime notes, under these circumstances the IMF link actually appears quite attractive to China and Japan, as it gives them a convenient way out of the problem by letting the Fund play the role of the bad cop with its enforcement while the two lenders can deny responsibility.[22] This may explain why even the lenders, especially China, have not pushed hard on surveillance issues despite the fact that the problem of moral hazard is essentially a lender's concern.[23]

While the political tensions running on the two aforementioned axes among the great powers are widely known, relatively little attention has been drawn to the tension running on the third axis, between the lenders and the borrowers. Surveillance and enforcement are far more politically costly to the borrowers than the lenders. The difficult decisions that China and Japan must make are decisions that necessarily reflect the lenders' interests first and foremost, and it is not unreasonable to expect that the borrowers' interests would be relegated to a secondary concern. *Ex ante* surveillance is not the real issue here, however. After all, hardly any country takes the IMF's Article IV consultation as an insult to its sovereignty, for a good reason: policy reviews carry no teeth, and even the IMF has no real leverage against any member state until and unless it approaches the Fund with hat in hand. It is *ex post* surveillance – conditionality, in other words – that is at the heart of the concern.

The question is simple: will the lenders, China and Japan, be any more neighborly than the United States just by virtue of their geographic proximity? Will they somehow be more enlightened, more generous, and more altruistic than the United States in coming to rescue their neighbors? Will they be more resistant to the temptation of using a crisis as a leverage against the borrower and seizing it as an opportunity to get their way? Are China and Japan, in short, any less likely to generate the "politics of resentment" than the United States, which has been the driving force behind the whole initiative? Answering these questions with an affirmative nod would require a number of rather heroic assumptions about not only state behavior in general but also the politics and history of East Asia, to say nothing about a big dose of optimism.

In essence, strengthening the independent surveillance capacity of the CMI is a double-edged sword for the potential borrowers: it is a prerequisite to the removal of the IMF link, without which the CMI cannot provide sufficient financing independent from Washington, but such a robust surveillance mechanism will necessarily impose significant costs on the borrowers. While it is the latter edge that the potential borrowers wish to blunt, doing so necessarily renders the other

22. William Grimes, "The Asian Monetary Fund Reborn?" *op. cit.*, p. 97.
23. Wen Jin Yuan and Melissa Murphy, *op. cit.*

edge dull as well. In other words, even though delinking from the IMF is clearly attractive to the borrowers, it is attractive only to the extent that the CMI's surveillance and enforcement mechanism would be less intrusive and onerous than that of the IMF. There is no reason to believe that a delinked CMI with a rigorous surveillance mechanism would somehow be kinder and gentler to the borrowers than the IMF, and, by extension, China and Japan would somehow be more altruistic and less self-interested than the United States. On the contrary, the recent decision by the Japanese to let its $US57bn BSA with Korea outside of the CMI framework lapse rather than renew it, widely seen as a politically motivated decision amid escalating diplomatic rows over Dokdo Island, shows that any liquidity support scheme, even a "neighborly" one, is a leverage that can be exploited by the lender for its own purposes. In fact, during the 1997 crisis, the United States was not the only country that benefited from the market opening that was forced upon Korea in exchange for the IMF rescue. Despite all its talks of being the champion of its downtrodden neighbors, Japan did not let the opportunity slide by to pry open Korea's markets for its own corporate interests. The opening of the automobile market, for instance, was specifically coat-tailored for the Japanese automakers, and the capital market opening allowed Japanese financial institutions to gain an important foothold in Korea's financial markets, especially in the highly lucrative alternative financial services occupied by non-bank financial institutions. For its part, China is no less prone to exploit its economic weight to pursue its diplomatic priorities, as shown by its 2010 export ban of rare earths to Japan, not to mention the aggressively retaliatory trade measures Beijing implemented against Korea during the so-called "garlic war" in 2002.

Given the competitive nature of Sino–Japanese relations, one may speculate that the cleavages and fault lines between China and Japan may present a window of opportunity for the borrowing countries to exploit, allowing them to play one off the other to extract maximum concession and minimize the conditionality. Alternatively, regional economic interdependence may persuade the lenders to assist their neighbors in more benevolent terms out of their own interest. It is not clear, however, that either scenario is likely for Korea, for a number of reasons. First, Korea tried this in 1997 when it approached both Japan and China for emergency bilateral loans. In a desperate attempt to avoid the IMF, Seoul had asked Tokyo not just once but twice for bilateral support, but to no avail, despite the fact that it was the Japanese banks that were the most exposed to Korea. After being rebuffed by Japan, Korea then turned to China for a lifeline, but this request, too, was summarily rejected. Second, Korea's economic interdependence with China and Japan is highly asymmetrical, tilting heavily against Korea. The nature of its economic dependence on China and Japan, moreover, is different: the former is Korea's largest export market and most important source of intermediary goods, while the latter is the key source of technology and capital goods. The asymmetrical shape of interdependence implies reduced leverage for Korea, while the different nature of its economic dependence on China and Japan means that they are not substitutable, which makes the juggling act that much more difficult and risky. Further compounding the problem is the fact that Korea has its own share of political fault lines with both China and Japan, most of which revolve around historical and territorial issues that are prone to incite deep-seated antagonism and stir up fervent nationalism as witnessed recently. Under such uncongenial circumstances and approaching from a position of asymmetrical interdependence, playing one off the other is much easier said than done, as is placing complacent expectations on the "enlightened," self-interested benevolence of China and Japan.

This is not to say that monetary cooperation in East Asia is to be ruled out entirely. But it does question the unstated assumption that monetary regionalism would somehow provide a kinder, gentler source of help. The seemingly never-ending Greek saga should serve as a further cautionary note about how such assumptions can be problematic. Even in the Eurozone, a region miles and decades ahead of East Asia in every aspect of regionalism, bailouts came with a long litany of unpleasant measures that were punishing enough to provoke massive riots. If it was unimaginable just a few years ago that angry Greek protesters would equate the present day Germany to Nazi Germany, and yet this is what we are seeing now, it is not so hard to imagine a similar scene unfolding in the streets of Seoul against Japan and China.

In sum, the road to a robust surveillance mechanism under the CMI framework is ridden with perilous implications. For the United States, the development of an effective regional surveillance mechanism means the loop will be finally closed on it for good; for China and Japan, it means having to make politically difficult decisions and take responsibility for them in an atmosphere of mutual distrust; and for the borrowers, it means replacing one form of surveillance and enforcement with another, the latter of which cannot be assumed to be any less rigorous than the former if it is to be at least as effective. Yet, without a robust surveillance mechanism, removing the IMF-link remains a distant prospect, and without removing the IMF-link, the CMI can neither function as a regional self-help system of liquidity support nor give the APT freedom from the United States. And herein lies the pitfalls of monetary regionalism in East Asia, explaining why the CMI remains unable to meet its twin objectives, and why Korea, along with other potential borrowers, should be cautious about counting on the CMI as a more benevolent Asian version of the IMF.

Conclusion

If a robust regional liquidity-support system remains a distant prospect, and replacing one lender with a geographically closer lender does not necessarily mean a kinder, gentler helping hand, where might Korea turn to address the persistent problem of acute and periodic instability in the face of financial globalization? Of course, a truly "self-help" strategy, one that can spare Korea from throwing itself at the mercy of any lender, be it the United States, China, or Japan, is relying exclusively on its own resources to ensure the resilience of its financial system. The prevailing strategy pursued by Korea and most other EMEs has been building a large "war chest" by accumulating massive amounts of foreign exchange reserves, but as is widely recognized, this is not a problem-free approach either, as reserve hoarding is a costly endeavor. In fact, reserve accumulation has exacted a hefty insurance premium on Korea, ranging from 0.5% of GDP to as high 1.9% a year, depending on what metric is used to calculate the cost.[24] Moreover, given the fact that Korea spiraled into a crisis in 2008 despite having accumulated over $US261bn in reserves, the cost-efficiency of reserve hoarding remains highly questionable.

There is a common angle to reserve accumulation and the CMI: both are attempts to improve Korea's liquidity position by focusing on the asset side – that is, on the resources it can mobilize in the event of a crunch. But this is just one side to the ledger. There is another, much neglected side to Korea's liquidity position: its heavy exposure to short-term liabilities and volatile forms of capital flows. There is no reason why enhancing Korea's liquidity position should be approached from the asset side alone, especially if this approach has been costly, ineffective, and generally too uncertain to deliver the desired outcome. In this light, the CMI is a Band-Aid solution to a problem that stems fundamentally from excessive financial openness, the extent of which far exceeds the present capability of East Asia to move toward "enlightened" monetary regionalism. At issue here is not the inadequacy of the CMI per se, nor the lingering memory of the humiliating trauma of 1997, nor the questionable reliability of China and Japan, but rather, the fact that Korea's continuing heavy exposure to short-term capital flows makes it all but impossible to escape from the capricious whims of global finance. This is not a problem that can be addressed by monetary regionalism if political autonomy is valued, but only if the Korean state reclaims at least some part of its traditional role as the gatekeeper of international capital.

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24. From 2001 to 2007, the cumulative quasi-fiscal cost of reserves – the cost on the central bank's balance sheets – is measured at 0.48% of GDP; the broadest opportunity cost of foregone investment is measured at 1.87%; and the narrowest opportunity cost measured as the difference between the returns on reserve assets and the returns on flight-prone foreign-held financial assets are measured at 1.3%. Youngwon Cho, "Burnt Twice: South Korea's Elusive Search for Financial Stability Since 1997," paper presented at the Annual Convention of the International Studies Association, San Francisco (3–6 April 2013).

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