ASIAN MONETARY FUND: FRIEND OR FOE

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Introduction

The current financial system was designed to support the Bretton Woods system, which was established towards the end of the World War II (WW II). The system was supported by several institutions, namely General Agreements on Tariffs and Trade (GATT - now known as World Trade Organization or WTO), International Bank for Reconstruction and Development (IBRD - now known as World Bank) and International Monetary Fund (IMF). The main objective of GATT was to promote trade liberalization, while IBRD was intended to finance long-term development programs and the IMF to help finance countries with serious short-term balance-of-payment difficulties.

The Bretton Woods system came into being with the goal of creating a symmetrical system. However, in reality, the world economy was dramatically asymmetrical because it relied heavily on the United States (US). The system functioned well during the 1950s and 1960s; it brought monetary stability, trade liberalization, and rapid economic growth. But, the US economy was unable to sustain its support for the system. Therefore, on 15 August 1971, US President Richard Nixon decided to "float" the US dollars. Since that moment, the world has entered into a system of "flexible exchange rate".

Three decades after the collapse of the Bretton Woods system, the international financial system continues to rely on this system's existing institutions. It must be noted that these institutions were designed to operate in a fixed exchange environment. Even though they made various adjustments, the constellation of the international monetary and financial systems underwent dramatic changes. For example, Germany and Japan have emerged into new economic powers in their respective regions. Also, there has been tremendous development in the communication sector due to technological advancement. Capital transactions can be carried out in an unprecedented amount and speed.

The effectiveness of these institutions, notably IMF, has been challenged several times. The most recent challenge was the Asian economic crisis, which was first prompted by attacks against Thailand's Baht by currency speculators in 1997. The attacks cause severe currency depreciation in several Asian countries. As a result, these countries underwent serious balance-of-payment problems. Some of them (South Korea, Thailand and Indonesia) were required to make
structural adjustments as a pre-condition to receiving IMF’s funds. However, some of the recipient countries are already arguing that the IMF prescription has not provided the cure; instead, it has caused severe short term counter-productive impacts.

At the crucial period of the crisis, Japan came up with a proposal to establish an Asian-type IMF, known as the Asian Monetary Fund (AMF). However, this proposal was strongly rejected by the US, European countries and the IMF. In the end, the Japanese government ended its pursuit of this proposal and instead channeled their funds bilaterally and through currently established institutions.

The article intends to consider whether the AMF should be seriously taken into account considering the existence of the IMF. To achieve such purpose, firstly, it is significant to conceive the purpose behind Japan’s proposal by analyzing its economic interest in Asia. There needs to be some acknowledgement of Japan’s challenges in the past against western economic conception. Subsequently, the article hopes to elaborate on the IMF’s purpose and to what extent has it achieve its purpose in dealing with the Asian economic crisis. Afterward, arguments will be presented regarding to the AMF establishment debate. Lastly, even though AMF was not actualized, the desire for a reliable institution to ensure a stable monetary and financial system is definitely real for Asian countries. This is reflected by the establishment of Chiang Mai Initiative under the ASEAN+3 framework, which could be considered as a limited form of AMF.

Japanese Motivation

Japanese National Economic Interest

During the 1970s and 1980s, the Japanese government began its economic structural transformation to foster their competitiveness through a system of “economic cooperation”. This “economic cooperation” is an immensely institutionalized network between government institutions and private sectors for the purpose of exchanging information and coordinating policies. The main objective of this network is to ensure that there is a combination of aid, trade and investment to advance the growth of Japanese private sectors in Asia. In a way, this would also nurture Japan’s national economic interest abroad.¹

The success of this “economic cooperation” has resulted in Japanese private sectors’ foreign direct investment (FDI) and offshore production in Asia (especially in East and Southeast Asia) to increase substantially. One of the most crucial periods was the dramatic appreciation of the Japanese Yen in 1985, which in turn further increased Japanese investments in Asia. At the beginning of 1985, total employment by Japanese firms in Asia was only 500,000, but by 1995, it had increased to over 1.25 million.² The total value of FDI from small and medium-sized enterprises rose from 40% in 1986 to 90% in 1996.³ In sum, by mid-1990s

Japanese private sectors had made Asia as the production network for their products to increase their competitiveness.

In compliance with the intensive investment of the private sector, the Japanese government also channeled aids through official direct assistance and other official transfers to developing countries, especially those that are significant for Japanese foreign direct investments. Significant flows of financial resources from Japan to developing countries may be seen as follows: US$ 15,101 in 1993, US$ 17,081 in 1994, US$ 20,033 in 1995, US$ 10,386 in 1996, and US$ 13,244 in 1997.4

Due to Japan’s investment in other Asian countries, it is, therefore, natural that the Japanese are concerned with loans that were given to Asian countries in crisis. Outstanding loans to Thailand, South Korea and Indonesia by Japanese banks consist of US$ 83.9 billion, while US$ 265 billion are also at risk in other parts of Asia. As a whole, 40 percent of the total foreign lending by Japanese banks are designated to Asian countries.5

A prolonged Asian monetary and financial crisis would jeopardize Japan’s national economic interest because a large portion of Japanese aid, trade and investment is focussed in Asia. For that reason, the Japanese economy is highly dependent on East and Southeast Asian countries. Moreover, the on-going crisis in Asian countries would also have negative impacts on Japanese “economic reform”, especially in its financial sector.

Asian Development Model

Since the end of WW II, Japan has been able to develop its economy under US security umbrella. Japan implemented a strong government role in controlling market entry, guiding capital in key sectors, and directing foreign direct investments. Its success has led to many Asian countries imitating the Japanese development model. However, its is important to note that the Japanese economic boom in the 1970s and 1980s was under the influence of the US, whether it be in the security realm or the economic.

Japanese donation in various international organizations and financial institutions, including the IMF and the World Bank, has increased as its economy developed. The decision making process in these Bretton Woods’ institutions is mostly determined by the weight vote and extensive use of special majority.6 Nevertheless, despite Japan’s contributions, its weight vote had been under-represented compared with that of other members. Negotiations need to be conducted in order to decide changes to the weight vote system. However, most of the founding countries (e.g. the US, France, the United Kingdom) are likely to maintain their weight votes regardless of how over represented they actually are.

Japan cannot apply its “economic philosophy” widely in any of these Bretton

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Woods’ institutions due to the domination of the founding countries. For example, in a study on East Asia development that was funded by Japan, it was recognized that although government intervention is important in developing East Asian economies, this should be reduced in the future. There has been tension between Japan and the West over the importance of market intervention. The Japanese position is to subordinate financial policies under a broader industrial strategy, while the West considers that market or non-subsidized rates should determine financial policies.

Furthermore, contradiction between Japan and the West was also seen during the 1997 Asian crisis. The IMF provided a guideline, known as “Washington Consensus”, which uses free-market principles and monetary discipline as the basic policy prescription. An argument was made by a high ranking Japanese official from the Ministry of Finance (MOF) who stated that the IMF guidelines were inappropriate for developing countries which found themselves in a competitive economic environment. Many of these emerging economies are based on export-led development and emphasizes close linking with the IMF. The latter’s prescription of stringent financial discipline and monetary control has been a serious problem.
Vice Minister for International Affairs in the Ministry of Finance, Eisuke Sakakibara, proposed an independent AMF. This proposal was put forward during the Group of Seven (G7) central bankers, finance ministers and IMF members meeting. In this proposal, Japan would initially provide US$ 100 billion for the AMF. Moreover, the AMF would operate without IMF-style structural adjustments programs. Therefore, it would not impose needy countries to make strict structural adjustments programs.

There were different responses towards this proposal. It may not be surprising that the Asian countries engulfed in crisis gave positive responses for the proposal (even Taiwan expressed its willingness to participate actively in AMF). However, China was more cautious in its response to the AMF proposal, but not entirely unsympathetic.

From the beginning, the US, Europe and the IMF strongly opposed Japan’s proposal. Michael Camdessus and several IMF officials stated that an AMF was unnecessary. Furthermore, Stanley Fischer, Senior Vice President of the IMF, cautioned that the idea was basically a threat to the IMF’s authority and effectiveness. In the US, the Clinton administration was pressured by the Congress to limit international resources for the administration. As a result, the IMF was the only main instrument for US to exercise its influence on the world’s monetary affairs. In an official statement, US Treasury Department Deputy Secretary, Lawrence Summer, rejected the AMF because it would endanger the central role of the IMF.

Ever since Japan’s economic success, it has developed a long-standing rivalry with Western countries on views regarding economic development models or philosophy. Japan believes that the IMF’s prescription for the Asian crisis relief is not wholly applicable for the region’s economies. Structural adjustments – emphasizing on free-market and strict monetary principles – may not be suitable if adopted directly to Asian economies without any period of transition, well-calculated social safety net or a priori adaptation. In the worse scenario where the prescription fails, Japan could be directly affected by the contagious impacts of the crisis. Under the circumstances, Japan responded by introducing a proposal to establish the AMF. It was hoped that a regional IMF-like institution would respond better in overcoming the regional crisis. However, the proposal could also be considered as another form of Japanese resistance against the West’s dominant role in the international monetary and financial systems. On that account, the US immediately showed strong opposition to the idea.

**IMF: Purpose and Handicap**

One of the main purposes of the IMF (as mentioned before) was to provide assistance to countries experiencing short-term international payments imbalance. This is stated in Article I (ii) of the Articles of Agreement. The Agreement states that the IMF’s purpose is to assist the expansion and balanced growth of international trade. Thus, the IMF was created to reduce the cost of international financial crisis for needy countries. In essence, there are two major roles for the IMF: (1) to conduct surveillance of...
of the international community, and (2) to lend cash (with conditions tied) as a last resort to getting out from economic pitfalls.

Surveillance can be considered as a secondary objective of the IMF. To some extent surveillance have already been conducted by other institutions, both private (e.g. credit rating agencies) and public (e.g. the OECD). Nonetheless, the absence of effective early warning and early action systems would be fatal. The problems of Thailand and South Korea had been foreseen by some analysts; however, not many had anticipated the Indonesian and Malaysian crisis. Actually, no one had actually predicted the regional spread of the downturn. In this sense, the IMF, as the body responsible for conducting surveillance of the world’s economies, had been inadequate in monitoring the international monetary system and the financial flow throughout the regions.

As part of the Bretton Woods system, the role of lending last resort, the IMF monopolizes bailout cash. Such a monopoly has allowed the IMF to lend its money with strict conditions, such as what they perceive as the promotion of macro and micro economic structural adjustment for the purpose of improving long-term economic prospects. However, it should be noted that IMF structure and policy direction need to be accommodating towards recipient countries’ various types of economic and social uniqueness.

The IMF has a guideline policy agreement called the Policy Framework Paper (PFP). This document, which was drafted in Washington, is usually filled-out when an IMF mission arrives in a recipient country. The guideline is based on the “Washington Consensus” policy, which uses free-market principles and monetary discipline as a form of prescription for ailing economies.

The IMF conducts a multiple layer-monitoring network, in which the Executive Committee would monitor the Secretariat. The process would be based mainly on reports from recipient countries. The report would then be evaluated to see whether or not policy changes outlined in the agreement have been made. There are some criticisms against this process. In some cases, however, Executive Committee members are known to serve their own national interest by preferring to assist their own countries’ needs. The Committee has also attempted, in other occasions, to influence bureaucratic matters within the IMF.

Judging from the work of the IMF, it is apparent that the institution applies a uniform menu for every country in need of assistance; there is minimal consideration of these countries’ different types of economic, social and cultural backgrounds and conditions. The IMF seems to use its monopoly role to impose strict conditions, which are suitable solely according to the West’s standards. It appears as if recipient countries are seen as laboratories for the IMF’s experimentation of orthodox economic policy and theories. Such a view was once pointed out by an official from Japan’s Ministry of Finance, who indicated that the IMF’s conditions are insensitive to the “social” costs of financial and corporate restructuring in Asian countries.

One of the most severe examples of the IMF’s inadequacy can be seen in its response to Indonesia’s cry for help at the peak of the Asian crisis. Many of the IMF’s demands did not weigh the extent of their

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15 Ibid.
16 Ibid.
17 Ibid.
18 Ibid.
19 Ibid.
social consequences. Firstly, no security measures were taken before the liquidation of a series of Indonesian banks (such as prior deposit insurance). This created a major panic across Indonesia. The IMF’s action discredited the Indonesian government’s monetary and financial systems, and importantly, its authority. In the end, the liquidation process worsened the monetary and financial crisis. Secondly, the IMF strictly demanded abolition of subsidies for food and fuel without providing any advice on how to develop a transitional period or well-calculated social safety net. The abolition of subsidies resulted in skyrocketing prices of food and fuel, and endangered the whole economic system. The middle and lower classes were the ones affected the most. The poverty rate was pushed to the highest point it has ever been in Indonesian history. In the end, this condition triggered a major social unrest throughout the archipelago.

On the whole, the IMF’s surveillance role has not met its original expectation due to its failure to acknowledge the magnitude, depth and regional nature of the crisis. It subsequently failed to notify the danger of the crisis to those troubled Asian countries. Even though IMF, as a “bailing-out” institution, has the power to impose conditions on its loans, the institution also has to play the role of a “wise” advisor and not impose insensitive, inflexible, one-sided prescriptions. On paper, the prescription put forward by the IMF may sound adequate. However, being negligent of the social consequences of these conditions actually made the situation in Indonesia worse. All in all, the IMF mishandled the timing and pace of the structural adjustment of problem countries’ economies and did not make any necessary preparation prior to the application of such policies.

### Rationalization of the AMF

The original AMF proposal was Japan’s reaction to the on-going crisis. The Japanese was concerned with the contagious effect of the crisis. They perceived that a lengthy crisis would reduce market trust in the Asian economies. Therefore, it is in Japan’s best interest to see the end of the crisis. The AMF proposal had been rejected so hastily that it did not give enough opportunity for Japan to produce a comprehensive proposal.

Those who favor the AMF argue that because of its regional nature the institution would suit better the needs of Asian economies. Firstly, the AMF might be more suitable to perform surveillance in the region compared to the IMF because the former efforts would be focused simply on the region. Secondly, the AMF could provide additional funds to needy countries, thus fortifying the IMF’s bailing-out role. The regional fund from the AMF could be distributed appropriately, while taking into consideration the macro and micro economic perspectives special to the countries in Asia. Thirdly, the AMF gives more appreciation to different types of social, political and cultural conditions in each of these countries. Hence, the establishment of an AMF was expected to help overcome balance-of-payment imbalances among Asian countries using terms that are best suited for each country.

Many experts have expressed caution over the AMF’s vague proposal. There are many items that remain unexplored, or plainly non-existent. It is difficult to evaluate the AMF objectively because matters con-

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20 Ibid.
21 Ibid.
cerning its structure, mechanism of disburse-
ment, and total fund are still not clear.

Characteristics of the AMF are of-
en where the basis of criticisms arises. For instance, the AMF would consist mostly of
developing countries and the amount of mem-
bers would be limited; thus, the total amount of funds would be limited. Also, the AMF
would probably be overly dependent on Ja-
pan as its main engine. In comparison, the
IMF consists of 182 member countries,
which are mostly developed coun-
tries.

More pessimistic views of the AMF
outline a four other downside effects of the
institution’s existence. Firstly, international
monetary stability and credibility in the ex-
change market can be considered as public
goods. Therefore, it would be less expen-
sive and less confusing to produce them
through a single institution, namely the IMF.
The establishment of another institution might
cause competition in macro-economic policy
prescriptions. Competing advises might con-
fuse investors, and in the end might under-
mine confidence in both institutions. 22 Sec-
ondly, borrowing money from the IMF is al-
ready a “dangerous” matter for many un-
stable governments, especially considering
nationalism issues. The establishment of two
or more institutions would only worsen this
condition. Thirdly, there is no certainty that
Japan would effectively replace the US’s
leadership role in re-structuring collapsed fi-
cancial and economic systems. It is often
argued that Japan’s reluctance to lower tar-
iffs and other trade barriers at Asia Pacific
Economic Cooperation (APEC) is a signal of
its reluctance to bear the burden of lead-
ership. Fourthly, by channeling their aid
through the AMF, the Japanese government
would in the future no longer be able to pro-
vide large amounts of direct assistance to
foreign countries. This is mostly because
Japan has been providing stimulus packages
numbering around US$ 4.6 trillion in Japa-
inese gross debt to rescue insurers, the bank-
ing sector, and un-funded pensions. 23

It would be beneficial to have a com-
prehensive proposal of the AMF or an insti-
tution similar to AMF. With the limited infor-
mation of the institution, it is difficult to eval-
uate the AMF thoroughly. However, the po-
tential of the creation of an AMF-like insti-
tution in the future should not be foregone
theoretically and empirically. The idea should
not be hastily dismissed simply because it
challenges the authority of one’s institution
or one’s national interest. If the establish-
ment of an AMF might complement the func-
tion of the already-established Bretton
Woods institutions (e.g. the World Bank and
the Asian Development Bank), then the idea
of establishing an AMF should be sincerely
put into consideration.

ASEAN+3

During the 33rd Asian Development
Bank Annual Meeting in Chiang Mai, North-
ern Thai City, an agreement, known as
Chiang Mai Initiative, was formed. With US$ 200 million initial fund, a ‘network’ of cur-
rency swap arrangement was created to
serve as a ‘firewall’ against future monetary
or financial crisis in Asia. 24 The agreement
made a web of bilateral pacts to swap and
repurchase central bank reserves between
the big five members of ASEAN with Ja-
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22 Ibid.
23 Ibid.
24 “Regional Currency Swap Arrangement: A Step To-


wards Asian Monetary Fund?”. Internet. Website http://
Under the initial proposal of AMF, Japan encountered several constraints and one of the most significant constraints was China (this was overshadowed by the Western opposition). In the past, there had been fluidity in the relations between Japan and China. Moreover, the two countries are considered to have political and economic leadership ambition in Asia. However, under the ASEAN umbrella, the rivalry between the two countries had been set aside for a moment. Another important country that must be accounted with in an Asian regional economic cooperation is South Korea. Presumably, South Korea does not want to play a secondary role to Japan or China. Thus, it was fortunate for ASEAN to have South Korea’s participation.

The Chiang Mai Initiative successfully assembled ASEAN member countries with China, Japan and South Korea under the same roof because under the ASEAN+3 framework ASEAN is placed in the stirring wheel, while Japan, China and South Korea participated in an equal footing.

Another significant factor of the arrangement’s success was that the framework did not include Hong Kong, or Taiwan. This was advantageous since it is very hard to persuade China to participate if those countries were included.

Nonetheless, it must be cautioned that the total fund collected through the Chiang Mai Initiative is regarded as very limited to overcome significantly future monetary or financial crisis. The countries in the region must establish an excellent coordination among themselves in disbursing the fund. A small amount of fund may quickly be drained and will only have short-term effects.\(^{25}\)

With the founding of the Chiang Mai Initiative, the Southeast and Northeast Asian countries have a structure and an excuse to further discuss concretely regional economic issues. The growing desire from all major countries in the region to establish a regional cooperation or institution would be regarded as an opportunity for Asia to proceed with Japan’s initial proposal of the AMF. Even though it might be a “smaller-scale” compared to the initial proposal, a milestone has been established for further cooperation among the countries. However, Washington still continues to oppose any creation of an institution or arrangement that might weaken US influence over the economies in the region or replace IMF’s role. Edwin Truman, Senior official from the US Treasury Department, cautioned that the main objective of any regional surveillance arrangement, should be to promote timely economic and financial adjustments.\(^{26}\)

**Conclusion**

The current international economy still depend on Bretton Woods institution as its “governing body”, however, features of the international economy have changed dramatically since the time when these institutions were established. This is extremely significant for the IMF, since it has to deal with countries in crisis situations. IMF has to rapidly respond to a crisis and present applicable solutions for ailing countries. During the 1997 Asian crisis, IMF was unable to acknowledge the magnitude, depth, and regional nature of the crisis; thus, IMF could not give early warning or early action directions to troubled countries.

In the height of the crisis, Japan offered a proposal to establish AMF, since a

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\(^{25}\) Ibid.

\(^{26}\) Ibid.
prolonged crisis could endanger Japan’s economy. Moreover, contradictory economic views between Japan and the West, probably also triggered Japan’s announcement of its proposal. However, the Western countries and IMF immediately rejected the AMF proposal before it had been clearly conveyed. Consequently, with the limited information, it will be difficult to review AMF comprehensively. With the finite information, had been put forward regarding to the advantage and disadvantage of AMF, but in the end AMF was never formed. Nevertheless, the need for a reliable institution to ensure stabilization in the monetary and financial system is clearly shown through the Chiang Mai Initiative. The majority of Chiang Mai Initiative’s participant had undergone the economic crisis, hence, it was substantial for these countries to have a safeguard for any future crisis, apart of the existing institutions.

The potential of building an institution that might have complementary role with the current Bretton Woods institution must be considered objectively since it might mend the shortcoming of these institutions. The stability of the international monetary system must not be subordinated by any narrow national interest or a group of nations interest. Due to the nature of intense fluidity of the monetary and financial system, one must open every alternative to any arrangement or institution that might improve the stability of the international economic.