Rebuilding Global Markets

The Dragon and The Samurai To The Rescue

Shu-Ching Jean Chen 05.29.09, 2:15 AM ET

Is it time to create Asia's answer to the West's International Monetary Fund?

The ten ASEAN countries in South East Asia, plus their three heavyweight neighbors in the north -- China, Japan and South Korea -- apparently think so.

The current financial crisis is the main catalyst, but the idea would go nowhere without the dragon and the samurai -- China and Japan -- agreeing to temporarily suspend their mutual suspicion.

A key breakthrough came early this month when ASEAN plus three, as these countries are known as a group, finally agreed in Bali to create a US$120 billion regional reserve fund. The deal came after China and Japan, the two largest contributors to the fund, buried their hatchets and agreed to each fork out an equal sum, or 32% of the total needed to create the fund.

If the regional reserve fund succeeds, it would represent the first regional institution in Asia that is blessed with real financial power and with teeth to enforce discipline among members. But the hard part is only beginning, with negotiations to set up a multilateral surveillance institution now under way. The success, or the lack of it, will determine how far Asia will move towards regional integration.

Hadi Soesastro, senior fellow of Jakarta-based Centre for Strategic And International Studies, said the new institution wasn't designed "to replace the IMF, but to supplement it."

But first, there are details to be worked out.

For a start, how the voting power would be vested is an issue of contention. Both China and Japan, as well as South Korea, the third-largest contributor to the fund, favor following the quota system used by the IMF. That gives big contributors a greater say in decision-making.

Together, the China-Japan-Korea trio agreed to commit 80% of the fund, theoretically giving them 80% of the weight in decision-making, based on the IMF model.

The idea, naturally, does not sit well with the ten ASEAN countries, which would be left with a mere 20% vote jointly.

If there were any chance for this proposal to be accepted, analysts suggest, it would be in the forming of informal alliances such as for ASEAN nations to vote as a bloc with Japan, or with South Korea, for example, to balance China's power.

The intense behind-the-scenes juggling already bodes ill for the creation of a surveillance institution that can rise above the fray.

The two largest economies in Asia, Japan and China, have long been reluctant to see the other winning the upper hand for power and influence in the region.

South Korea, the other major contributor to the fund, is trying to play the significant other in the triangle relationship, without appearing to take sides.

"Monetary cooperation is difficult to do without an independent supra-national institution," says Klaus Regling, an EU Fellow at Lee Kuan Yew School of Public Policy, and formerly Director-General for Economic and Financial Affairs of the European Commission. "Coordinating crisis management, organizing one Asian voice in international forums, all that would be very difficult to achieve without an independent regional institution that can provide critical political input."

Japan set the ball rolling at the height of Asian financial crisis in 1997 by suggesting the creation of an Asian Monetary Fund, a proposal spurned by the U.S. and IMF as it was seen as an alternative to the bitter medicine the IMF prescribed to cash-strapped Asian countries including Thailand, Indonesia and South Korea.

Talks about creating an Asian Monetary Fund have dragged on for a full decade, and could be delayed further. But the enthusiasm China has recently shown in staking a claim on international financial affairs is cause for a modicum of optimism.

Already, Chinese analysts are abuzz with talks of using the regional fund as a vehicle to promote the use of its currency, the yuan, through the issuance of "dragon bonds." This would be similar to the additional commitment Japan made to the regional fund to allow member countries to raise capital in Japan by issuing "samurai bonds" denominated in yen to Japanese investors.

The latest breakthrough in Bali was a result of China and Japan meeting each other half way, with Japan consenting to China matching the sum of its contribution by including Hong Kong's share, and with China agreeing to Japan's contributing a higher percentage as a proportion to its GDP.

Sometimes, the dragon and the samurai do speak the same language, however difficult it may be.