

Financial Community Building in East Asia

The Chiang Mai Initiative: Its Causes and Evaluation

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Yoon Jin Lee

I. INTRODUCTION

During the turmoil of Asian Financial Crisis 1997-1998, when Japan contributed a quarter of the emergency package for Thailand while the U.S. pledged nothing, the Japanese government assessed that an Asian Monetary Fund would be conceivable¹. The Asian Monetary Fund (hereafter, AMF) that the Japanese Ministry of Finance envisaged was a \$100 billion fund with a regional financial surveillance system and emergency loan facility. Yet, when Japan delivered the AMF proposal officially, in November 1997, American and Chinese opposition quickly shot the idea down on the basis that such a fund would be unnecessary with the IMF in place².

Nonetheless, since the passage of Chiang Mai Initiative in May 2000, when Finance Ministers of thirteen ASEAN+3 (ASEAN plus China, Japan, and Korea) countries agreed to establish a network of bilateral currency swap arrangements, the level of financial cooperation has been growing rapidly in East Asia. Though it is commonly understood that shared experiences from the shock of Asian Financial Crisis is what motivates financial cooperation in East Asia today, constructivists go further and claim that a new regional identity – born from those shared experiences – is what drives community building efforts in East Asia's financial domain. Some system-centered international relations theorists argue that hegemonic rivalry between China and Japan is what propels the initiative forward, while others stress that examination of individual actors is critical in solving the cause of increasing financial cooperation. But which actor, among multiple regional parties, is key? This paper finds that China's self-interests and proactive attitude towards community building in East Asia has been the primary catalyst of regional financial cooperation.

Another equally important step in understanding the past decade of community building in East Asia's financial realm is its evaluation. Many critics of the initiative point out the fact that only Indonesia took advantage of Chiang Mai Initiative, when the latest global financial crisis hit East Asia in 2008. In fact, Japan, Korea, and Singapore have arranged temporary, bilateral currency swap deals with the U.S. Federal Open Market Committee³. So is Chiang Mai Initiative truly "Much Ado About Nothing", as John Ravenhill coins East Asian regionalism? By scrutinizing the reasons behind non-utilization of Chiang Mai Initiative, and by inspecting long-run financial indicators of a

¹ Japanese Ministry of Finance. The Council on Foreign Exchange and Other Transactions, "Lessons from the Asian Currency Crises – Risks Related to Short-Term Capital Movement and the 21st Century Type". 1998-05-19. <http://www.mof.go.jp/english/tosin/ela703.htm>

² Lipsy, Phillip Y. 2003. "Japan's Asian Monetary Fund Proposal". *Stanford Journal of East Asian Affairs*. Vol.3, No.1 (Spring).

³ U.S. Federal Reserve News Announcement. <http://www.federalreserve.gov/newsevents/press/monetary/20081029b.htm>.

sample of ASEAN+3 countries, this paper finds that Chiang Mai Initiative is more of a symbolic significance, which nevertheless promotes regional financial security, constructive and balanced integration of China into the region, and union of Northeast Asia and Southeast Asia into one East Asian region – dispatching powerful international repercussions. This paper also briefly provides some suggestions to make the initiative truly effective.

The rest of this paper is organized as follows: Section 2 briefly outlines the progress of Chiang Mai Initiative over the last decade; Section 3 investigates several factors driving forward the financial community building in East Asia; Section 4 evaluates the outcome of financial community building efforts; and Section 5 concludes.

II. HISTORICAL BACKGROUND OF CHIANG MAI INITIATIVE

The roots of Chiang Mai Initiative (hereafter, CMI) go back to third informal ASEAN+3 Summit in 1999, when the heads of ASEAN+3 countries agreed to enhance financial cooperation mechanisms in East Asia and established an annual Finance Ministers' meeting⁴. At the inaugural ASEAN+3 Finance Ministers meeting, the actual agreement of CMI was reached, and the progress of CMI since then can be characterized into three phases. In initial phase, the number of bilateral currency swap arrangements concluded amongst ASEAN+3 countries grew. In 2001, ASEAN Swap Arrangement among Indonesia, Malaysia, Philippines, Singapore, and Thailand was expanded to include rest of the ASEAN member nations, and the size was increased to \$1 billion. In 2002, six bilateral currency swap arrangements were reached, and six more were concluded by 2003. Four additional arrangements were concluded in 2003, amounting to a total of sixteen bilateral currency swap arrangements. Table 1 illustrates a comparable increase in the size of the total pot.

The second phase of CMI was marked by creation of Asian Bond Markets Initiative in 2003, with an initial Asian Bond Fund size of \$1 billion. The first Asian Bond Fund was invested in a basket of *dollar* denominated bonds, issued by eight ASEAN+3 countries (China, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, and Thailand), and following the success of the first one, a second Asian Bond Fund worth \$2 billion was formed to invest in *local* currency denominated bonds⁵. The Asian Bond Markets Initiative focused on enhancing market infrastructures to foster bond markets in East Asia as well as facilitating access to the bond markets through a wider variety of issuers and bond types⁶. The Asian Bond Markets Initiative strikes deeply at structural weaknesses of the regional financial system, since the previous absence of a stable, long-term debt market in East Asia had rendered the origins of 'double mismatch' problem⁷; although Northeast Asian savings were high, most deposits in local banks were channeled out to international financial centers, generating a 'maturity mismatch', and were flowed back into Southeast Asia as short-term foreign currency loans, producing a 'currency mismatch'. Table 2 delineates the progress of Asian Bond Markets Initiative since its establishment.

⁴ Joint Statement on East Asia Cooperation.

⁵ Japanese Ministry of Finance. "Regional Financial Cooperation among ASEAN+3". http://www.mof.go.jp/english/if/regional_financial_cooperation.htm

⁶ Japanese Ministry of Finance. "Regional Financial Cooperation among ASEAN+3".

⁷ Chairman's Press Release on the Asian Bond Markets Initiative.

The third, and current, phase of the initiative can be characterized by two components: 1) integration of Economic Review and Policy Dialogue into CMI, and 2) multilateralisation of CMI. The Economic Review and Policy Dialogue (hereafter, ERPD), which played the role of regional economic and financial surveillance, was established by ASEAN+3 Finance Ministers prior to the launch of CMI, but as the self-help and mutual support mechanisms of CMI required regional monitoring system, ERPD was incorporated into the initiative. Next, the process of CMI multilateralisation (hereafter, CMIM) began when ASEAN+3 Finance Ministers agreed to transform one-way bilateral currency swap arrangement to two-way arrangement in 2005. In the same year, the Ministers decided to improve the initiative's drawdown mechanism, or the size of swap that could be withdrawn without IMF supported program, from ten to twenty percent of the aggregate pool⁸. Finally, in May 2009, the agreement on all main components of the CMIM was reached; the total size of CMIM was to be \$120 billion, with the contribution proportion between ASEAN member nations and Plus Three countries at 20:80. Tables 3 and 4 show each country's contribution and borrowing accessibility, as well as decision-making mechanisms of CMIM. The CMIM was implemented in March 2010 and to coordinate CMIM, an Independent Surveillance Unit, to be located at Singapore, is expected to start operation by May 2011⁹.

III. CAUSES OF THE PROGRESS OF CHIANG MAI INITIATIVE

What accounts for the demonstrated progress of CMI? The methodology used to examine several potential factors, responsible for the growing momentum of East Asian financial cooperation, has one major assumption and four simple parts:

Assuming that Asian Monetary Fund and Chiang Mai Initiative are essentially similar, as the two ideas espouse abundant liquidity provision and less stringent conditionalities for crisis-stricken countries,

- (i) the *dependent variable* is the outcome of financial community building efforts (e.g. failure of AMF, progress of CMI, number of bilateral currency swap arrangements, etc.),
- (ii) and *independent variable* is the explanatory factor accounting for the outcome of financial community building efforts,
- (iii) then *independent variable of interest* is the one which demonstrates that variations of itself account for variations in the dependent variable.
- (iv) *The variations in both independent and dependent variables can be spatial and/or temporal variations.

Using such logic, this paper sorts out whether the shock of Asian Financial Crisis, emergence of a new regional identity, hegemonic rivalry between China and Japan, or self-interests of individual regional actors is the *independent variable of interest* in (iii).

a) The Shock of the Asian Financial Crisis 1997-1998

It is commonly understood that shared experiences from the shock of Asian Financial Crisis is the chief impetus of CMI. Indeed, the haywire of Asian Financial Crisis made many East Asian countries realize that their economies are closely tied together¹⁰. A proposition that can be deduced from this explanation is that since the

⁸ Joint Statement of ASEAN+3 Finance Ministers' Meeting (2005).

⁹ Sussangkarn, Chalongsob. 2010. "The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook". ADBI Working Paper Series, No. 230 (July).

¹⁰ Wade, Robert. 2000. "Wheels within Wheels: Rethinking the Asian Crisis and the Asian Model." Annual

impact of crisis varied across countries, there would be a spatial variation in the levels of financial cooperation efforts across states. For instance, if this explanatory factor were true, countries that were hardest-hit from the crisis – Thailand, Indonesia, South Korea, Malaysia and Philippines¹¹ – would exhibit highest levels of cooperation efforts, while least-hit countries would demonstrate lowest, or no, levels of financial community building efforts. Presuming that the number of bilateral currency swap arrangement concluded by a country through CMI is a proxy of the country's level of cooperation efforts, this paper compares the number of arrangements made by hardest-hit countries with that of least-hit countries and the data from Table 5 shows contradictory evidence.

Although it is the case that least-hit countries, like Brunei, Cambodia, Laos, Myanmar, and Singapore, concluded none or one bilateral currency swap arrangement, other least-hit countries like China and Japan concluded the two highest numbers of bilateral swap arrangements. Since China was relatively insulated from the world and regional economy at the time of the crisis, the impact of the crisis was meager, and yet data indicates that China concluded six arrangements. Likewise, in relative terms Japan was not as severely affected by the crisis as other hardest-hit countries, and yet data indicates that Japan actively concluded seven arrangements. The greatest shortcoming of this explanation, however, is that there is no temporal variation in explanatory factor, as shared experiences from the shock were present since the crisis started. Thus, it cannot account for the temporal variation in the dependent variable, which encompasses failure of AMF in 1997 and progress of CMI since 2000. In sum, because there is no variation in the independent variable, the shock explanation does not sufficiently account for the variations in the dependent variable.

b) The Emergence of a New Regional Identity

Extending the abovementioned shock explanation, constructivists claim that emergence of a new regional identity is the chief driving force behind the progress of CMI¹². According to this approach, formation of a new East Asian identity is defined against the other – IMF and the U.S. – since Asian countries believed that the IMF was being too harsh and the U.S. was doing too little to manage Asian Financial Crisis. In fact, there were criticisms against IMF's poor handling of the crisis, and such mismanagement by the Fund prompted many Asian countries to realize that they cannot rely solely on the IMF in future¹³. Another expectation from this constructivist explanation would be that countries with higher degree of identification with new regional identity would exhibit greater efforts of regional financial cooperation – as measured by high numbers of bilateral swap arrangements under CMI – while countries with lower degree of identification with the regional identity would exhibit lesser efforts.

Though there is no survey data on ASEAN+3 Finance Ministers' identification with new regional identity, there is Asia Barometer Survey (2004) data on the percentages of identification with transnational groups in various East Asian countries. From Graph 1, it is clear that while Southeast Asian countries, except Indonesia, display high percentages of identification with 'Asian identity', China and Japan show tiny percentages of identification with other transnational identities. Again, data gives

Review of Political Science.

¹¹ Wade, Robert. 2000. "Wheels within Wheels: Rethinking the Asian Crisis and the Asian Model."

Annual Review of Political Science.

¹² Chey, Hyoung-kyu. 2009. "The Changing Political Dynamics of East Asian Financial Cooperation: The Chiang Mai Initiative". Asian Survey. Vol. 49, No.3 (May/June).

¹³ Chey, Hyoung-kyu . 2009.

contradictory evidence; although it is true that countries with highest identifications with 'Asian identity', such as Philippines, Thailand, Singapore, and Malaysia, exhibit great efforts of regional financial cooperation, China and Japan – the two countries with lowest identification with 'Asian identity' – also demonstrate as much as, if not greater, efforts of financial cooperation, as indicated by the high numbers of bilateral swap arrangements these two concluded with other ASEAN+3 countries. Such mixed results are further complicated by the fact that there is a persistence of historical memories of Japanese occupation of the region, which gives rise to nationalistic sentiments manifested in the history textbook controversies and small islet territorial disputes with Japan¹⁴.

Yet again, the major weakness of this explanation is that there is no temporal variation in the independent variable, as new regional identity emerged from the Asian Financial Crisis debacle. In short, because the absence of variation in independent variable cannot account for the variations in the dependent variable, emergence of a new East Asian identity fails to be the independent variable of interest.

c) The Rivalry between China and Japan

Besides the shock and Asian identity explanations, some system-centered international relations theorists argue that rivalry between China and Japan is what propels financial cooperation in East Asia today. For example, Takashi Terada (2006) argues that as two superpowers compete for a hegemonic role in the region, they make more and more contributions to East Asian community and such competition of 'who contributes more' and thus 'who has higher leverage' work to benefit other regional actors, such as ASEAN¹⁵. In fact, Japan's interest in bilateral free trade agreement with South Korea in 1998 prompted China to propose China-ASEAN FTA in 2000, feeding Japan in turn to launch full-fledged negotiations for Comprehensive Economic Partnership between Japan and ASEAN in 2003¹⁶. Similar workings of Sino-Japanese rivalry seem to be manifested in the joint statements of ASEAN+3 Finance Ministers' meetings. As shown by clauses appreciating China and Japan for their contributions to CMI, in Table 6, it appears that the two powers competed over 'who contributes more' and thus 'who has higher leverage' in the regional financial community building process.

Unfortunately, a critical limitation of the usefulness of this explanation is that there is neither spatial nor temporal variation in the independent variable to account for variations in the dependent variable. Thought it makes sense that Sino-Japanese rivalry explanation has no spatial variation, its lack of temporal variation, due to the fact that Sino-Japanese rivalry and distrust existed from far back, is a serious deficiency. Moreover, other system-centered theorists like Gilbert Rozman (2004), among others, contend that bilateral distrust, rivalry, and enmity between China and Japan stunted the progress of East Asian regionalism in general¹⁷. Indeed, regional financial 'cooperation' may not extend far from 'competition'.

d) The Interests of Individual Regional Actors

Many political scientists put emphasis on self-interests and domestic politics of individual actors when explaining an international phenomenon. In particular, if a state is large enough to affect rest of the world, then changes in that state could account for

¹⁴ Gong, Gerrit. 2001. "The Beginning of History: Remembering and Forgetting as Strategic Issues," Washington Quarterly, 24:2 (Spring).

¹⁵ Terada, Takashi. 2003. "Constructing an 'East Asian' Concept and Growing Regional Identity: from EAEC to ASEAN+3". *The Pacific Review*. Vol.16, No.2.

¹⁶ Terada, Takashi. 2003.

¹⁷ Gilbert Rozman. 2004. Introduction in *Northeast Asia's Stunted Regionalism: Bilateral Distrust in the Shadow of Globalization*. Cambridge University Press.

changes outside of the state. Indeed, in international economics, a change in the domestic interest rate of a big economy, like that of the U.S., brings a parallel change in the world interest rate. Yet, because this self-interest of individual actor explanation does not have spatial variation, examining temporal variation of the individual actor would be the means of accounting for temporal variations in the dependent variable.

d.1. Japan, Korea, and ASEAN

To begin with Japan, Korea, and ASEAN, these regional actors persistently called for regional financial cooperation, whether it was AMF in 1997, CMI in 2000, Asian Bond Markets Initiative in 2003, or CMIM in 2005, and such invariable nature of their interests and stances do not fit the temporal variations in the dependent variable. According to the Japanese Ministry of Finance's report, "Lessons from the Asian Currency Crises", Japan was indirectly affected by Asian Financial Crisis because it was deeply integrated with other regional economies. For instance, twenty-five percent of regional lending was from Japan, and Japanese banks stood at greatest risks when crisis broke out in Thailand¹⁸. Whereas the U.S. ran trade deficit with Thailand, Japan ran a trade surplus and was the largest FDI investor in Thailand¹⁹. Thus, Japan was far more susceptible to the effects of the crisis than was the U.S. This is why Japan preferred abundant liquidity provision without heavy conditionalities, while the U.S. wanted limited liquidity with stringent conditionalities that demanded sensitive political and structural reforms²⁰. Yet, because Japan was underrepresented in IMF, it could not avert the Fund from choosing U.S.'s side to provide Indonesia with an emergency package with harsh, long-term conditionalities. Indeed, while the U.S. voting rights in IMF was 17.08 percent, Japan had a share of 6.09²¹. Thus, even after the failure of AMF, Japan employed both official and unofficial channels to persuade the U.S. of the importance of East Asian financial cooperation and proposed the CMI in 2000²². Yet, as Japan's "throwing money behavior"²³ without tackling the real issue was criticized, Japan again proposed Asian Bond Markets Initiative in 2003. Nonetheless, Japan was unable to take a highly overt role by 2005, and so it looked to multilateral frameworks to help legitimize its efforts to lead the region.

Similarly, South Korea and ASEAN were consistent and strong advocates of East Asian financial cooperation, chiefly because they were the hardest-hit countries that suffered most from Asian Financial Crisis. Like Japan, they were also severely misrepresented at IMF; ASEAN countries together had a meager 3.5 percent of the vote, and South Korea's share stood directly below that of Libya's²⁴. The shared experiences from harsh conditionalities attached to the loans from IMF heightened a sense of prevention of another crisis through coordinate efforts. In addition, intrusion of IMF into the spheres of political, social, and structural governance of ASEAN was thought to go

¹⁸ Japanese Ministry of Finance. The Council on Foreign Exchange and Other Transactions, "Lessons from the Asian Currency Crises – Risks Related to Short-Term Capital Movement and the 21st Century Type". 1998-05-19. <http://www.mof.go.jp/english/tosin/ela703.htm>

¹⁹ Lipsy, Phillip Y. 2003. "Japan's Asian Monetary Fund Proposal". *Stanford Journal of East Asian Affairs*. Vol.3, No.1 (Spring).

²⁰ Lipsy, Phillip Y. 2003.

²¹ Lipsy, Phillip Y. 2003.

²² Hook, Glenn D., J. Gilson, H.W. Christopher, and Hugo Dobson. "Japan and the East Asian Financial Crisis: Patterns, Motivations, and Instrumentalisation of Japanese Regional Economic Diplomacy".

²³ Lipsy, Phillip Y. 2003. "Japan's Asian Monetary Fund Proposal". *Stanford Journal of East Asian Affairs*. Vol.3, No.1 (Spring).

²⁴ IMF Board Submits Resolution to Governors for 45 Percent Quota Increase. 2001. Press Release Number 97/63. 1997-12-23. <http://www.imf.org/external/np/sec/pr/1997/pr9763.htm> (8 May 2001).

against their primacy of sovereignty, and a picture of an IMF officer hovering over the Indonesian President as he was signing the loan package was widely circulated to arouse sentiments against the U.S. and the West²⁵. Although AMF did not become feasible, South Korea and ASEAN repeatedly called for the idea, and when CMI was approved in 2000, these regional actors concluded as many bilateral currency swap arrangements as possible. Both also endorsed Asian Bond Market Initiative in 2003 and when South Korea proposed CMIM in 2005, ASEAN lent its full support, because as a group of small countries, they preferred a regional institution where no sole power can dominate. In sum, because the self-interests of Japan, Korea, and ASEAN were static throughout the past decade, these regional actors do not account for the variations in the dependent variable.

d.2. The Change in the U.S. Interests and Stance?

In 1997, the U.S. was a major opponent of the AMF idea, criticizing its nature of duplicity, likeliness of moral hazard, and lessening of American influence in the region. Yet, the U.S. thereafter reduced its level of opposition and approved CMI in 2000. For the U.S., as long as the aims of financial community building efforts in East Asia were to supplement, and not substitute, existing international financial institutions like the IMF, regional financial cooperation was acceptable. The U.S. was further assured by the fact that CMI was directly linked to IMF, through its drawdown mechanism. Moreover, establishment of a sound bond market in East Asia, through the Asian Bond Markets Initiative, was deemed to create new investment opportunities for the U.S.²⁶. A healthier financial system in East Asia was expected to reduce U.S.'s own coordination costs and burdens associated with handling future crises in the region²⁷. As Donald Hellmann (2007) connotes, the U.S. was engaged in "strategic inattentiveness" as the regional financial cooperation efforts lined up with its own interests²⁸.

So, does the temporal change in the interests and stance of the U.S. account for temporal variations in the dependent variable? Possibly yes, but this paper finds a major deficiency in this explanation; although the change in U.S.'s stance can help explain the temporal change, from failure of AMF to successful *passage* of CMI, it falls short of explaining the *progress* of CMI, since the U.S. is not even a part of ASEAN+3. The U.S. did not contribute to increases in either the number of bilateral swap arrangements or the size of total pot, and it did not come up with either the Asian Bond Markets Initiative or the CMIM. Though the positive change in the U.S.'s stance may have had a bearing, it would certainly be an indirect one and is unsatisfactory in embodying the direct cause of the progress of CMI. After all, the business of CMI is about 'East Asian' financial cooperation and not about 'Asia-Pacific' financial cooperation.

d.3. China's Self-Interests and Increasingly Proactive Stance

On the other hand, temporal variations in China's self-interests and stance towards regional financial cooperation account for temporal variations in the dependent variable very well. To begin with the failure of AMF in 1997, China did not support the idea not only because of the pressure from the U.S. but also because there was a little sense of crisis in the country. Jennifer Amyx (2005) also highlights that China did not

²⁵ Hellmann, Donald C. 2007. "A Decade After the Asian Financial Crisis: Regionalism and International Architecture in a Globalized World". *Asian Survey*. Vol. 47, No. 6.

²⁶ Sutter, Robert G. 2000. "China: Recent Policy Priorities--Implication for U.S.: Interests and Policy Goals". Library of Congress, Washington D.C.

²⁷ Chey, Hyoung-kyu. 2009. "The Changing Political Dynamics of East Asian Financial Cooperation: The Chiang Mai Initiative". *Asian Survey*. Vol. 49, No.3 (May/June).

²⁸ Hellmann, Donald C. 2007. "A Decade After the Asian Financial Crisis: Regionalism and International Architecture in a Globalized World". *Asian Survey*. Vol. 47, No. 6.

support Japan's AMF proposal, because the proposal occurred when there were intensifying negotiations over the country's accession to WTO²⁹. Indeed, China applied for its entry to WTO and received the final approval of its accession in December 2001. The efforts to enter the WTO was part of a broader, economic reform agenda, which began when "more programmatic and technocratic Chinese leaders started a debate on the dynamics of nation-building after Mao Zedong's death in 1976"³⁰. As Chinese leadership started to struggle with legitimacy problems in 1990s, survival of the system could only be "guaranteed through foundations for long-term economic growth"³¹. In this light, it was in Beijing's interest to oppose AMF proposal in 1997, since its aim was not to go against, but go along with, the U.S., IMF, WTO and other international institutions.

Although China gave its consent to Japan's proposal of CMI in May 2000, it was still not a major proponent of the initiative, as China's accession to the WTO was not approved until December 2001. As well, China was initially reluctant about CMI, because its role was to be a lender, and the initiative failed to provide back any material benefits for the country³². With regards to a possible default by borrower countries, CMI even required China to bear risk. Still, China lent its support for the initiative, because it desired to appease its threat-perception by ASEAN³³. Indeed, by 1999, China had become the tenth largest trading nation in the world and second largest receiver of FDI. Consequently, ASEAN's mounting apprehension spurred many Chinese officials to seek ways of appeasement and get involved with regional financial cooperation efforts³⁴. By the time Asian Bond Markets Initiative was launched, however, China switched from taking a reluctant to a more proactive stance towards regional financial cooperation. Since 2002, as an official member of WTO, China had a timetable set for trade liberalization and financial deregulation to meet the global standards³⁵. Thus, it was apparent that while the country was sheltered from prior financial crises, it would become more vulnerable to future shocks as it opens up its banking and financial sectors. As well, because of its rapid economic growth of ten percent per year, China was expected to enjoy lesser degree of access and benefits from the World Bank as well as Asian Development Bank than it did in the past³⁶. In addition to these financial burdens, tangible economic incentives were high for China if Asian Bonds Markets Initiative could be successfully realized. The creation of a regional bond market was deemed to help China's situation, by eliminating risks inherent in local bond markets, introducing economies of scale to improve liquidity, and providing incentives for the Chinese

²⁹ Amyx, Jennifer. 2005. "What Motivates Regional Financial Cooperation in East Asia Today?" *Asia Pacific Issues*. No. 76 (February).

³⁰ Sutter, Robert G. 2000. "China: Recent Policy Priorities--Implication for U.S.: Interests and Policy Goals". Library of Congress, Washington D.C.

³¹ Morrison, Wayne M. 2000. "The Growth of the Private Sector in China and Implications for China's Accession to the World Trade Organization". Congressional Research Service. Library of Congress, Washington D.C.

³² Amyx, Jennifer. 2005. "What Motivates Regional Financial Cooperation in East Asia Today?" *Asia Pacific Issues*. No. 76 (February).

³³ Ravenhill, John and Jiang Yang. 2009. "China's Move to Preferential Trading: A new direction in China's diplomacy". *Journal of Contemporary China*. Vol. 18 (January).

³⁴ China Daily. "Indonesia, China to develop trade co-op". 2009-8-24. http://www.chinadaily.com.cn/bizchina/2009-08/24/content_8609069.htm

³⁵ WTO website. http://www.wto.org/english/news_e/pres01_e/pr243_e.htm

³⁶ Amyx, Jennifer. 2005. "What Motivates Regional Financial Cooperation in East Asia Today?" *Asia Pacific Issues*. No. 76 (February).

government to pursue various investor-friendly reforms³⁷. In fact, on its own, China had to have faced enormous hurdles for successful development of a national bond market, as long-term bond issues require stable institutions, credible regulatory oversight, and rating agencies with the capacity and will to guarantee bond solvency. And through regional collaboration, China could achieve financial stability from these long-term bond issues.

China's active engagement with the regional financial community building process was met by Japan's mounting sense of competition. By 2005, Japan succeeded in inviting three of its close democratic states – India, Australia, and New Zealand – to create ASEAN+6 grouping. Meanwhile, China increasingly pushed to elevate ASEAN+3 to the center of East Asian regionalism as it stood more at its core than at ASEAN+6. Indeed, at 9th ASEAN+3 Summit Meeting in 2005, Chinese Premier Wen Jiabao stressed how ASEAN+3 successfully evolved into a system featuring “dialogue on an equal footing, consensus-building, mutual benefits, and win-win results”³⁸. Hence, when South Korea suggested CMIM in 2005, China endorsed the plan and actively increased its contributions. As well, Long Yongtu, the chief negotiator for China's WTO accession, argued that the business sector should be a primary force in the CMIM process and warned that without contributions from the private sector, CMIM would turn into “empty talk”³⁹. So under Chinese leadership, a group of private sector participants was formed to join CMIM and was discuss cross-border transactions and settlement issues in 2008.

Overall, temporal variations in China's self-interests and increasingly proactive attitude towards financial cooperation in East Asia satisfactorily account for temporal variation in the dependent variable, starting from failure of AMF and passage of CMI to subsequent progress of the initiative. Hence, this paper finds that change in China's self-interests and stance has been the key impetus of the financial community building efforts in East Asia over the last decade.

IV. EVALUATION OF CHIANG MAI INITIATIVE 2000-2010

Besides the search of causes behind the progress of CMI, the evaluation of the initiative is an equally important step in understanding the past decade of financial community building processes in East Asia. Yet, as mentioned in Introduction, critics of CMI, who contend that CMI is merely a symbolic gesture, point out the fact that only Indonesia utilized the initiative when latest global financial crisis hit the region. As a matter of fact, Japan, Korea, and Singapore individually concluded a bilateral currency swap arrangement with the U.S. Federal Open Market Committee; Japan arranged \$60 billion in September 2008, while Korea and Singapore each arranged \$30 billion with the U.S. in following October⁴⁰. Indonesia too wished to arrange a similar bilateral currency swap deal with the U.S., but the U.S. did not agree to the deal⁴¹. This paper finds that

³⁷ Lejor, Paul and Douglas Arner, Liu Qiao, Mylene Chan, Marshall Mays. 2003. “Asia's Debt Capital Markets: Appraisal and Agenda for Policy Reform”. Hong Kong Institute for Monetary Research Working Paper (October).

³⁸ People's Daily. “Chinese Premier Hails the Achievements of 10+3”. 2005-12-12. <http://english.people.com.cn/90001/90777/90851/6306156.html>

³⁹ China Daily. “Regional Economic Integration Benefits All”. 2005-3-30. <http://www.china.org.cn/english/BAT/124201.htm>

⁴⁰ U.S. Federal Reserve News Announcement. <http://www.federalreserve.gov/newsevents/press/monetary/20081029b.htm>.

⁴¹ Sussangkarn, Chalongsob. 2010. “The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook”. ADBI Working Paper Series, No. 230 (July).

CMI is more of a symbolic significance – not because of its non-utilization by ASEAN+3 countries during the latest global financial crisis – but because of the technical *reasons* behind its non-utilization.

First of all, the amount of liquidity a country could access from bilateral currency swap arrangements with other ASEAN+3 countries under CMI was too scanty, mainly due to the drawdown mechanism. The size of swap that could be withdrawn, without getting involved with the IMF, was only twenty percent of the total amount a country could pool together from its arrangements. For example, in the case of Korea, though it could have accessed \$18.5 billion from the swap arrangements made with other ASEAN+3 countries, it could only access \$3.7 billion without having to take part in the IMF programs⁴². In relation, because CMI did not have any means of expanding this \$3.7 billion through contributions by other ASEAN+3 countries on a voluntary basis, the amount of liquidity remained meager. In order to access the total amount pooled under CMI, countries had to get involved with IMF, but since it was politically risky to take part in IMF programs, crisis-hit countries looked for an alternative to improve their liquidity conditions. For these reasons, Korea was anxious to arrange the deal with the U.S., when U.S. Federal Open Market Committee made arrangements only with ten countries (Great Britain, Switzerland, EU, Denmark, Norway, Sweden, Canada, Japan, Australia, and New Zealand)⁴³. Hence, South Korean Finance Minister, Kang Man Soo, had to urge the U.S. to do the same towards the four emerging markets (South Korea, Singapore, Brazil, and Mexico), by stressing the importance of potential “reverse spill-over” effects made by the four if no deal was to be given way⁴⁴.

Even though the crisis-hit countries, except Indonesia, did not utilize CMI for the aforesaid reasons, this does not necessarily mean that CMI is unsuccessful and worthless. Indeed, by examining long-run financial indicators of eight ASEAN+3 countries – China, Japan, Korea, Indonesia, Malaysia, Philippines, Singapore, and Thailand – this paper finds that CMI promotes regional financial security. As shown in Tables 7 and 8, both amounts of foreign exchange and total reserves of eight ASEAN+3 countries steadily increased after the passage of CMI in 2000 until the recent global financial crisis hit in 2008. The only exceptions of decreases in foreign exchange and total reserves from those of previous year’s are the three cases of Philippines and Singapore in 2002 and of Japan in 2009. Nonetheless, the amount of decreases is virtually negligible. As well, besides the case of Philippines, net exports of Korea, Malaysia, Singapore, and Thailand in Table 9 indicate trade surpluses in these countries since 2000 until 2008. Only Thailand experienced a trade deficit in between the period, in 2005. Apart from accretion of foreign exchange and total reserves, most countries in the region – except Indonesia and Korea – kept their levels of short-term foreign debts low⁴⁵. This is why Malaysia, Philippines, and Thailand were not as severely affected by the global financial crisis in 2008, as they were in 1997-1998. In addition to growing financial stability in the region, as revealed by various financial indicators, interview with an official in charge of CMI at

⁴² Sussangkarn, Chalongsob. 2010. “The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook”. ADBI Working Paper Series, No. 230 (July).

⁴³ South Korean Ministry of Finance and Strategy News Announcement http://www.mosf.go.kr/_news/news01/news01a.jsp?boardType=general&hdnBulletRunno=60&cvbnPath=&sub_category=131&hdnFlag=&cat=7&hdnDiv=&&actionType=view&runno=86045&hdnTopicDate=2008-10-30&hdnPage=5

⁴⁴ South Korean Ministry of Finance and Strategy News Announcement (same as above)

⁴⁵ Sussangkarn, Chalongsob. 2010. “The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook”. ADBI Working Paper Series, No. 230 (July).

the South Korean Ministry of Finance and Strategy, Eun-Sook Park, confirmed the tendency of CMI in promoting financial stability, both domestically and regionally⁴⁶.

Another positive aspect of CMI, despite its non-utilization during the recent global financial crisis, is that it allows for constructive and balanced integration of China into the region⁴⁷. Tables 10 and 11 display the positive effects of China's constructive integration into the regional financial markets. Both intra-regional FDI share and portfolio share increased dramatically since 2000-2001, and such higher shares indicate higher degree of dependency on regional financial activities. Indeed, any disastrous scenario occurring in China would afflict the whole region, since many East Asian economies are tied to that of China's⁴⁸. In 2009, even when it was arduous to resolve the issue of 'who contributes more' to the total pot of CMIM, at the end of the day, China and Japan agreed to make equal amount of contributions for the sake of making CMIM work. Such agreement was a reasonable compromise as China's level of foreign reserves is the largest in the region, while Japan's size of GDP is the biggest in the region. Yet, because each of the two giants will find it difficult to accept if the other was to contribute more to the financial community building process, it is expected that China's integration into the region will continue to be a balanced one.

Finally, in spite of its symbolic character, CMI encourages on the union of Northeast Asia and Southeast Asia into one East Asian region, transmitting powerful international repercussions. In previous times, not only was the cooperation among Plus Three countries difficult, but the union of Plus Three and ASEAN countries into one East Asian region was also unimaginable due to differences in culture, tradition, history, ethnicity, and language⁴⁹. Yet, when Asian Financial Crisis hit in 1997-1998, both Northeast Asian and Southeast Asian countries realized that they were closely tied together. The ASEAN+3 grouping solidified the concept of East Asia as one region, and since the passage of CMI, there has been intense cooperation between the two parts of the region. As shown in Table 8, many ASEAN+3 have been accumulating foreign reserves at a rapid pace, that by the end of 2008 "East Asian economies had more than \$4 trillion of foreign reserves, accounting for over 55% of the world's foreign reserves"⁵⁰. As a region with more than half of the world's financial resources, financial community building processes in East Asia can affect some of the most important global financial variables, policies, and infrastructure. On the whole, even though CMI is more symbolic than practical, the initiative nevertheless has had positive impacts on the region.

Before concluding, this paper provides three suggestions to make CMI truly effective. Firstly, more liquidity provision should be made available through CMIM for the crisis-hit countries. This can be achieved by de-linking CMI from the IMF, or if this option is politically impossible, at least its drawdown mechanism should be improved further than its present percentage. In addition to such an improvement, official means of contributions from other ASEAN+3 countries, on a voluntary basis, should be instituted. As has been noted in Introduction, when IMF arranged an emergency package worth

⁴⁶ Phone interview with Mrs. Eun-Sook Park, an official in charge of CMI at South Korean Ministry of Finance and Strategy. 2010-08-09. (88) 02-2150-4812.

⁴⁷ Prasad, Eswar. 2004. "China's Growth and Integration into the World Economy: Prospects and Challenges". IMF Occasional Paper No. 232.

⁴⁸ Ba, Alice. 2003. "China and ASEAN: Renavigating Relations for a 21st-Century Asia". Asian Survey. (Jul/August).

⁴⁹ Ba, Alice. 2003.

⁵⁰ Sussangkarn, Chalongsob. 2010. "The Chiang Mai Initiative Multilateralization: Origin, Development and Outlook". ADBI Working Paper Series, No. 230 (July).

\$17.2 billion for Thailand during the Asian Financial Crisis, less than one quarter of the sum (\$4 billion) actually came from the Fund, and the rest came from contributions by Japan and other countries in the region⁵¹. To make the aggregate pool of CMIM larger, India, Australia, and New Zealand could be invited to join CMIM. Secondly, instead of its current ‘burrowing quota’ concept, CMIM should maintain the CMI’s original ‘currency swap’ concept, primarily to make CMIM easily accessible to needy countries without causing any political pressure. Psychologically, financial ‘swap’ is less of a burden than ‘burrow’. The CMIM could perchance collaborate with Executives’ Meeting of East Asia-Pacific Central Banks (EMEAP) to implement such multilateral ‘swap’ process. Lastly, mechanisms of CMIM should be monitored and coordinated by a professional staff. Presently, the regional financial community building process is carried out by ASEAN+3 Finance Ministers, and Deputies, on a part-time basis. Hence, to make the initiative more effective and efficient, a full-time secretariat is necessary. Perhaps, the newly created Independent Surveillance Unit can perform the function in Singapore.

V. CONCLUSION

After the failure of Japan’s AMF proposal in 1997, relentless efforts of financial community building in East Asia came into fruition in 2000 in the form of CMI. Since then, unprecedented level of regional financial cooperation was driven by China’s self-interest and proactive attitude. Starting from a network of bilateral currency swap arrangements, CMI came far to evolve into a multilateral pool of liquidity support. Though various procedural reasons behind non-utilization of CMI during the recent global financial crisis indicate that CMI is more of a symbolic significance, the initiative nevertheless promotes financial stability, positive integration of China, and meaningful union of Plus Three and ASEAN countries into one East Asian region. Hence, this paper provides two messages on the topic of financial community building in East Asia:

- (1) East Asian financial community building process was able to take off and progress due to the consent and increasingly active participation of China, the largest and most influential actor in the region.
- (2) Even if the present state of East Asian financial community building efforts is more symbolic than practical, it still has significant, positive effects on the region.

In ending, this paper stresses that ASEAN+3 countries should continue on with their financial community building efforts to make their self-help and mutual-support mechanisms resourceful and functional. Further developments of CMIM in the next decade will be much waited for.

⁵¹ Hamada, Koichi. 1999. “From the AMF to the Miyazawa Initiative: Observations on Japan’s Currency Diplomacy.” *The Journal of East Asian Affairs* XIII, No. 1 (Spring/Summer).

FIGURES AND GRAPHS

Table 1. The Progressive Increase in the Total Size of the Network⁵²

Year	Aggregate Amount
2002	\$17 billion
2003	\$31.5 billion
2004	\$36.5 billion
2005	ASA doubles to \$2 billion
2006	\$75 billion
2007	\$80 billion
2009	\$120 billion

Table 2. The Progress of the ABMI Since 2003⁵³

Year	Progress of ABMI
2003	<ul style="list-style-type: none"> • 1st ABF worth \$1 billion invested in dollar denominated bonds issued by 8 ASEAN+3 countries
2004	<ul style="list-style-type: none"> • 2nd ABF worth \$2 billion invested in local currency bonds issued by the same 8 ASEAN+3 countries • 6 voluntary working groups established to address the following areas: <ol style="list-style-type: none"> 1. Thailand: Creating new securitized debt instruments 2. Korea: Credit guarantee mechanisms 3. Malaysia: Foreign exchange transactions and settlement issues 4. China: Issuance of bonds denominated in local currency by Multilateral Development Banks (MDBs), foreign government agencies and Asian multinational corporations 5. Singapore and Japan: Local and regional rating agencies 6. Indonesia, Philippines, and Malaysia: Technical assistance coordination
2008	<ul style="list-style-type: none"> • Agreement on New ABMI Roadmap, which focuses on the 4 key areas: <ol style="list-style-type: none"> 1. Promoting issuance of local currency denominated bonds 2. Facilitating the demand of local currency denominated bonds 3. Improving regulatory framework 4. Improving related infrastructure for the bond markets
2009	<ul style="list-style-type: none"> • Established the Credit Guarantee and Investment Mechanism (CGIM) as a trust fund of the Asian Development Bank with initial capital of \$500 million, in order to support the issuance of local currency denominated corporate bonds in the region and contribute to developing regional bond markets

⁵² Joint Statements of ASEAN+3 Finance Ministers' Meetings (2002-2009).

⁵³ Joint Statements of ASEAN+3 Finance Ministers' Meetings (2003-2009).

Table 3. Individual Country's Contribution and Borrowing Multiplier in the CMIM⁵⁴

Country	Contribution (US\$ Billion)	Borrowing Multiplier
Brunei	0.03	5
Cambodia	0.12	5
China	38.4 (China: 34.2 & Hong Kong: 4.2)	China: 0.5, Hong Kong: 2.5
Indonesia	4.77	2.5
Japan	38.4	0.5
Korea	19.2	1
Lao PDR	0.03	5
Malaysia	4.77	2.5
Myanmar	0.06	5
Philippines	3.68	2.5
Singapore	4.77	2.5
Thailand	4.77	2.5
Vietnam	1.00	5

Table 4. Decision-Making Mechanisms of the CMIM⁵⁵

	Issues	Rule of Decision-Making
Fundamental Issues	Review (size, contribution, and borrowing multiples), Re-admission, Membership, Terms of Lending, etc.	Consensus
Lending Issues	Lending, Renewal, Default, etc.	Majority

Table 5 . Number of BSAs Concluded by Country from 2002 to 2004⁵⁶

	Japan	China	ROK	Thailand	Malaysia	Indonesia	Philippines	Singapore
2002	5	2	1	2	1		1	
2003	1	2	4	1	2	1	1	
2004	1	2	1			2	1	1
Total	7	6	6	3	3	3	3	1

⁵⁴ Joint Statement of ASEAN+3 Finance Ministers' Meeting (May 2009).

⁵⁵ Joint Statements of ASEAN+3 Finance Ministers' Meetings (2002-2004).

⁵⁶ Joint Statements of ASEAN+3 Finance Ministers' Meetings (2002-2004). Although the total number of BSAs is 16 to date (2009), the grand total in Table is 32, because each BSA is counted twice i.e. Japan-Thailand BSA is counted as one for Japan as well as one for Thailand.

Graph 1. Identification with Transnational Groups (Asia Barometer Survey 2004)⁵⁷

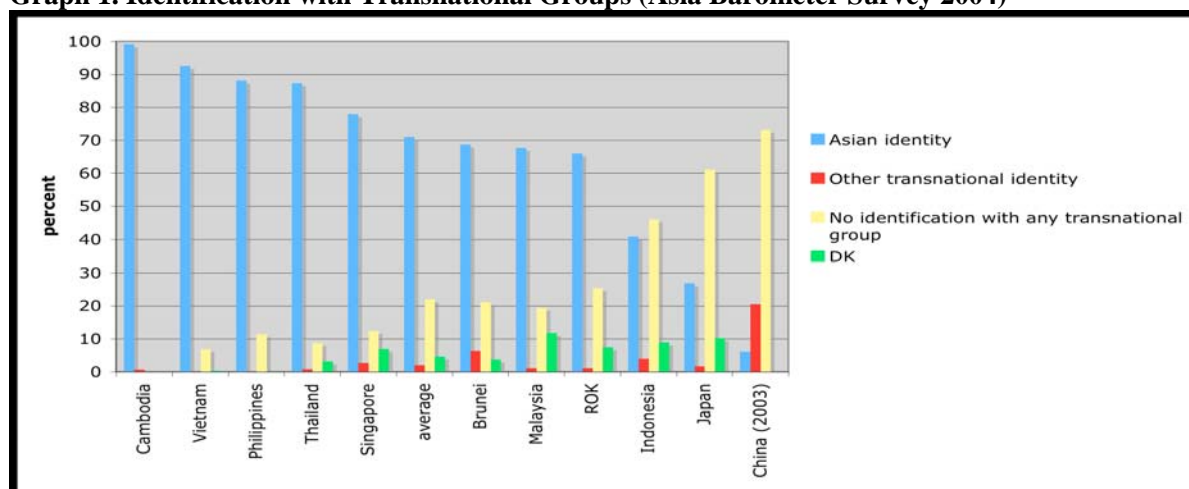


Table 6. Appreciated Countries and their Contributions⁵⁸

	Country/Countries Appreciated	Contributions Made by the Country
2000	Japan, China, and Korea	Technical assistance to the financial sector through training and seminars
2001	China	Arranged training courses on Economic Reforms and Development in China for ASEAN+3 Finance and Central Bank officials
	Japan	Financial assistance to member countries, through the ASEAN Secretariat, in the monitoring of capital flows in the region and the study of other appropriate mechanisms to promote financial stability
	Korea (2)	1) Initiative to organize a training program on financial and corporate restructuring for the ASEAN Finance and Central Bank officials 2) Initiative to organize an international seminar on early warning system modeling and joint regional monitoring
2002	China	Continued effort to arrange training course on Economic Reforms and Development in China for ASEAN+3 Finance and Central Bank officials
2003	Japan, ASEAN Secretariat	Workshop on Monitoring System for short-term capital flows
2004	Japan and Malaysia	Conduct study on the impediments on cross-border bond investments and issuance
	Korea and China	Co-chair the working group to explore ways to further enhance the regional credit guarantee and investment mechanism
	JAFTA*, Korea, and Malaysia	Technical assistance in capacity building efforts for the further development of regional bond markets
	China and Japan	Offers to provide financial assistance for studies and research
	China	Continue with training courses and seminars on the regional economy and financial cooperation

⁵⁷ Professor Iain Johnston's Lecture notes on East Asian Regional Identity. "International Relations of East Asia" course in Harvard Government Department.

⁵⁸ Joint statements of ASEAN+3 Finance Ministers' Meetings (2000-2004). JAFTA is Japan-ASEAN Financial Technical Assistance Fund to assist participating members technically.

Table 7. Foreign Exchange of Eight ASEAN+3 Countries (unit: \$US million)⁵⁹

	1995	1997	2000	2002	2005	2007	2008	2009
China	49499	103680	127080	210668	572930	967093	126343	1530370
Japan	116007	154060	266490	332072	579886	600130	651622	635939
Korea	21479	14608	73570	88863	146906	165651	130158	169168
Indonesia	8951	11923	21706	22622	23037	34638	32033	38637
Malaysia	15436	14833	21055	23846	48540	63683	58824	59237
Philippines	4211	5320	9958	9710	11055	19030	21455	23923
Singapore	46062	52610	61189	59997	80959	102843	112739	118649
Thailand	23857	19045	24509	27982	35334	53859	70323	85220

Table 8. Total Reserves of Eight ASEAN+3 Countries (unit: \$US million)⁶⁰

	1995	1997	2000	2002	2005	2007	2008	2009
China	51152	106250	129600	214815	575454	969055	1266210	1542340
Japan	124125	163641	273251	340088	584568	603794	656178	652926
Korea	21994	15107	73796	89271	147166	165908	130607	172201
Indonesia	9330	12401	21984	22889	23295	34872	32282	40628
Malaysia	16077	15489	21784	24579	48917	63967	59218	60915
Philippines	4428	5583	10299	10109	11316	19265	21723	24913
Singapore	46294	52910	61531	60478	81280	103121	113092	119796
Thailand	24292	19489	24655	28072	35560	54023	70641	86516

Table 9. Net Exports of Eight ASEAN+3 Countries (unit: \$US million)⁶¹

	1995	1997	2000	2002	2005	2007	2008	2009
China	16696	40422	24109	30426	102000	261536	297040	197620
Japan	107234	82203	99738	79532	79983	80709	23838	30292
Korea	-10061	-8452	11787	10345	23181	14643	-13268	38771
Indonesia	4762	4990	22329	21043	11090	24913	12155	26811
Malaysia	-3776	-288	16266	13395	26459	29253	45263	33791
Philippines	-10838	-13740	2755	-6780	-7084	-7437	-11279	-7426
Singapore	-6239	-7452	3259	8729	29602	36117	18396	24047
Thailand	-14347	-5508	7039	3462	-7980	12329	-5910	17236

Table 10. ASIA Intraregional FDI Share (in percentage)⁶²

2000	2001	2002	2003	2004	2005
51.36	45.71	63.99	67.16	50.76	79.11

Table 11. ASIA Portfolio share (in percentage)⁶³

2001	2002	2003	2004	2005	2006	2007
9.0	8.4	9.2	9.7	11.0	13.3	16.6

⁵⁹ IMF website. International Financial Statistics World Table.⁶⁰ IMF website. International Financial Statistics World Table.⁶¹ IMF website. International Financial Statistics World Table.⁶² Asia Regional Integration Center website. ASEAN+3 Process Initiatives.⁶³ Asia Regional Integration Center website. ASEAN+3 Process Initiatives.

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