

ASEAN's elusive search for Financial Safety

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On May 3, Finance Ministers and Central Bank Governors from the ASEAN+3 grouping (consisting of 10 ASEAN members and China, Japan and South Korea) issued a statement, following meetings in Samarkand, Uzbekistan. It recognised that the “conflict in the Middle East” had increased risks for the East and Southeast Asian region, requiring attention to the possibility of “excessive volatility and disorderly movements in financial markets and shifts in global liquidity conditions.”

In response, the ASEAN+3 governments are working to amend the Chiang Mai Initiative Multilateralisation (CMIM) arrangement, a network of dollar swaps backed by reserves of central banks in the region.

The amendment, when implemented, would transition the CMIM from being a contributory arrangement, with members pledging to release promised funds when any other member requests emergency financing, to being a Paid-in Capital Fund, where contributions are actually made upfront and transferred to a special legal entity, making it immediately available as and when required by balance of payments stressed countries.

This would bring the regional arrangement closest to an Asian Monetary Fund, or a regional alternative to the IMF — an idea that was mooted by Japan after the 1997 South-East Asian financial crisis and shot down by the US and the IMF, for fear of loss of their influence.

There is still some uncertainty as to whether the transition would go through. ASEAN+3 members have even now agreed only on three of the four principles that would govern the creation and functioning of the entity that would host and manage the paid-in corpus — these are that this legal entity must be independent of the member countries; it must recruit and deploy expert managerial and other personnel (to match the IMF perhaps); and that the system must be designed for effective coordination between its surveillance and lending functions.

But divergent national interests, the ASEAN statement confesses, have held back agreement on the fourth principle of ensuring a ‘sound management structure’, involving the all-important decision-making systems and oversight frameworks of the proposed independent entity.

This is no small matter. The effort to create a regional financial safety net in East and South-East Asia, has a long and tortuous history. It began almost five decades back in August 1977 when, faced with the uncertainties generated by the oil shocks, central banks and monetary authorities from the original ASEAN members (Indonesia, Malaysia, The Philippines, Singapore and Thailand) committed to providing “immediate short-term swap facilities to participating ASEAN member countries with temporary international liquidity problems.” The Arrangement provided for the sale of US dollars against the domestic currency of the requesting participant, along with a forward purchase of the same amount of domestic currency by the requesting participant for US dollars. The facility was backed by “pledges to

provide”, with members agreeing to share the burden of supporting requests for emergency balance of payments financing.

The arrangement has changed much over these five decades. One continuous change has been an expansion of the implicit ‘corpus’ backing the ASA, which began in 1977 at a small and inadequate \$100 million, touched \$2 billion in 2005. That was inadequate, since this was a period when, following liberalisation of the capital account, the balance and payments vulnerability of LMICs increased because of recurrent exit of foreign finance in a trajectory characterised by boom-bust financial flow cycles.

That necessitated substantially increasing the dollar commitments that back any meaningful financial safety net. At that time such a hike could not have been supported by just the ASEAN countries. But since the collateral effects of the South-East Asian crisis also affected the more developed countries in the region — China, Japan and South Korea — they were willing to support the safety net, resulting in the creation of the ASEAN+3 and the integration of the ASA into the Chiang Mai Initiative (CMI) in 2009.

The CMI had two pillars. One was an enhanced ASEAN swap arrangement, with contributions now set at \$1 billion. The second pillar was a network of bilateral swap arrangements under which countries could request a swap of their currencies for dollars up to an agreed amount. The CMI provided for negotiation of 33 bilateral currency swap arrangements of which 30 were between each of the Northeast Asian nations (China, Japan and South Korea) and each of the 10 ASEAN members and three were between the Northeast Asian nations themselves. This helped raise the dollar surpluses committed to backing the ASEAN financial safety net to a much higher \$120 billion in 2009 and \$240 billion in 2014. However, the system was still one involving bilateral swap arrangements, besides being backed only with “pledges” rather than an actual corpus into which dollar funds were transferred.

In fact, the problem with the CMI was the large bilateral component of what was a multilateral arrangement. This meant decision making and implementation were cumbersome, slow and uncertain. This inadequacy appeared stark after the 2007 financial crisis and was addressed by ASEAN+3 Finance Ministers in May 2009 with a decision that the arrangement must be multilateralised and transitioned to the Chiang Mai Initiative Multilateralised (CMIM).

The initial understanding was that of the total pool of \$120 billion, 80 per cent would be contributed by the Plus 3 countries and the rest by ASEAN countries. One issue was how the commitments to the pool would be distributed, since that would determine the relative influence (in the form of voting rights) of the different players, especially the plus-3 countries. Given the need to balance the influence of contesting powers China and Japan, China (along with Hong Kong) was allotted \$38.4 billion in contributions and proportionate voting rights, which equalled that of Japan (see table). That distribution remained when the “pledged corpus” was increased to \$240 billion in July 2014 with no other change of significance.

CMIM contributions as of 2009

	\$ billion	%
Plus three	96	80
China total	38.4	32
China	34.2	28.5
Hong Kong	4.2	3.5
Japan	38.4	32
South Korea	19.2	16
ASEAN	24	20
Indonesia	4.77	3.79
Malaysia	4.77	3.79
Philippines	3.68	3.79
Singapore	4.77	3.79
Thailand	4.77	3.79
Vietnam	1	0.83
Cambodia	0.12	0.1
Myanmar	0.06	0.05
Laos	0.03	0.03
Brunei	0.01	0.03
ASEAN+3	120	100

There was one more hurdle to cross. If and when large loans were provided, there was need for some degree of surveillance to ensure that the country “borrowing” dollars via the swap would be in a position to return the dollars and settle the transaction when the swap agreement expires. Neither China nor Japan would have liked to give the other the right to surveillance of the funding it provides through the now-multilateralised “pool” of bilateral swaps. To address this problem, while the rules governing individual swaps were left to be bilaterally negotiated, it was agreed that there was need to establish a link with the IMF for surveillance and monitoring, as a substitute for regional conditionality and monitoring.

Beyond a specified borrowing limit, a borrower from the CMIM was required to have entered into an agreement with the IMF and be subject to the latter’s conditionality and surveillance to be eligible for support. Initially any swap in excess of 10 per cent of the agreed amount in an arrangement required IMF surveillance. That was raised to 20, 30 and 40 per cent subsequently.

With hindsight we now know that nothing came of these cooperation efforts. Countries preferred to turn to the US Federal Reserve or bilateral swap agreements outside the CMIM in times of emergency. On the other hand, the CMIM has not been activated even once since its inception, despite balance of payments volatility. The principal explanation for that failure was the subordination of the regional agreement to the IMF. If obtaining a small sum from the CMIM safety net required IMF endorsement with a conditional loan, countries may as well opt for a direct and large loan, and the accompanying conditionality and surveillance, from the IMF.

Seen in this background the Samarkand promise to transition the CMIM from a “promise-to-pay” swap system to a Paid-in Capital (PIC) structure, which would make the war chest more easily accessible to balance of payments distressed countries while significant, is by no means transformational. What needs to be addressed is the ability of the regional arrangement to be able to take decisions on lending without having to rely on surveillance by the IMF. This makes the still absent agreement on the “fourth principle” on decision making structures and surveillance mechanisms extremely significant. If that is not resolved, either the PiC structure will not be formalised, or it will take a form in which once again utilisation will be minimal.

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