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THE ASIAN MONETARY FUND: AN OPPORTUNITY TO BE SEIZED

by

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In February this year, ASEAN plus China, Japan and Korea agreed to expand dramatically the scale of the Chiang Mai Initiative of bilateral swap arrangements and develop a more broadly focused institution. In effect to begin the journey towards an Asian Monetary Fund ('AMF'). This paper examines what a fully fledged AMF would offer the region. The national economic policies of East Asian nations have differed substantially from those of the Washington Consensus, and been more effective. An AMF would offer the chance to trial policies that give a larger role to national government and domestic demand, and a smaller role to foreign debt financing and export revenues, than do those of the Washington Consensus.

ASEAN comprises ten countries: Brunei, Cambodia, Indonesia, Malaysia, Laos, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. Its people number some 570 million.[1] Its combined GDP is only half as much again as Australia's, and one-third of China's.[2] Yet it thinks big. The grouping aims to become a European Union style economic community (but without a common currency) by 2015.[3]

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[1] John McLean, 'Will ASEAN's New Charter Bring Greater Cooperation?', *Development Asia*, April 2009, 20.

[2] ASEAN's 2008 GDP is US$1,506 billion, current prices, (selected Basic ASEAN Indicators as of June 2009, available at <http://www.aseansec.org/13100.htm>); Australia's 2008 GDP is US$1,011 billion, current prices, (World Economic Outlook, April 2009); and China's 2008 GDP, current prices, is US$4,402 billion (World Economic Outlook, April 2009).

[3] ASEAN, ASEAN Economic Community Blueprint, signed at the 13th ASEAN summit in Singapore, November 2007.

This, to me, is empty rhetoric. European union was underpinned by the need to combat profound security threats that had ravaged Europe twice last century, and for much of the preceding centuries. The decades of groundwork that paved the way for European union have not been undertaken in East Asia and, as an idea, East Asian union has nothing like the profile or support that European union had even 20 years before it came to pass, let alone the six years that are all that exist between now and 2015. Indeed the very concept of 'Asia' today is not nearly as strong as the concept of 'Europe' was 50 years ago. The core European countries were bound by a common religion, and a long history of fluid borders. China's borders are essentially similar today to what they were 2,000 years ago. The Vietnamese see their history as a separate people stretching back 4,000 years. Voltaire said of what was in some ways the precursor to modern Europe that, '[t]he Holy Roman Empire was neither Holy, Roman nor an Empire.' In similar ways 'Asia' today is a concept more used by those outside the region seeking to define or contain it, than by those who might seek to understand and appreciate it.[4]

So, for what it is worth, I think political union is a long way off. However, closer economic and financial integration is a different matter. Closer economic integration is proceeding apace. Closer financial integration is realisable and desperately needed; and may also, eventually, serve as part of the groundwork for political union.

Closer financial integration is realisable because East Asia has the world's largest foreign exchange reserves, highest savings rates and most dynamic economies.

Closer financial integration is desperately needed because the Washington Consensus policies promulgated by the International Monetary Fund ('IMF') and World Bank have been a conspicuous failure in promoting development, and just when the need for economic growth is at its highest, there is a vacuum in the International Financial Institutions as to the policy settings likely to promote it. Such integration is also desperately needed because over the past two decades, 'capital-account crises have been the norm rather than the exception.'[5] Its massive savings mean East Asia can do better.

[4] Compliments for this insight to Allan Behm of Knowledge Pond.

[5] Graham Bird and Ramkishen Rajan, 'The political economy of sequencing: Monetary versus trade regionalism', (2006) 17 *The North American Journal of Economics and Finance* 335, 336.

Greater regional integration of financial systems through an Asian Monetary Fund will lead to greater regional stability, which, in turn, should lead to more of these savings staying in Asia. The great paradox of the East Asian crisis of 1997 was that it was brought on by foreign capital losing confidence in a region with the world's highest savings rates. If East Asia could have kept its money at home, it never would have needed foreign capital, and there would have been no chance of a crisis provoked by money fleeing.

The region, especially with China's rise as 'factory for the world', has seen increasing levels of trade and economic integration. Many manufacturing processes today are centred in China but combine inputs from throughout the region in a hub and spoke system in which other nations contribute in their areas of comparative advantage to the Chinese production.

Trade integration has continued apace. ASEAN and China entered into a Framework Agreement on Comprehensive Economic Cooperation in 2002 and another agreement on trade in goods in 2004.[6] Under these agreements a free trade area will come into effect between China and ASEAN's five founding members and Brunei in 2010, and be extended to embrace ASEAN's other four members in 2015. In February 2009 ASEAN entered into a free trade agreement with Australia and New Zealand covering trade in goods, services, e-commerce, the movement of persons and investment.[7]

The region is developing a 'noodle bowl' of regional and bilateral trade agreements. For instance, in the case of Australia as well as the agreement with ASEAN and New Zealand considered above, there are bilateral agreements with Thailand, New Zealand and Singapore and ongoing negotiations for over four years and 13 rounds on a proposed Australia-China FTA and for two years and eight rounds on a proposed Australia-Japan

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[6] *Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China*, October 6, 2003, available at <http://dswww.aseanseco.org/15157.htm>; and *Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China*, Nov 29, 2004, available at <http://www.aseansec.org/16646.htm>.

[7] Joint Media Statement on the Signing of the Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area, Cha-am, Thailand, 27 Feb 2009, available at <http://www.aseansec.org/22255.htm>.

FTA. In the interests of trade, and especially administrative, efficiency one can but hope that one day this noodle bowl of different agreements will be replaced by one free trade area extending from New Zealand to China and South Korea to Australia and embracing all the nations within the East Asian region (and perhaps even India).[8]

However, the financial integration of the region has lagged far behind its economic and trade integration. In the words of an IMF study,

> intraregional financial integration – for example measured directly by cross-border capital flows or indirectly by cross-border correlation of consumption growth – has been more limited than elsewhere. Consequently, Asian economies appear to have become more integrated with countries outside the region than within the region.[9]

The seminal event, in terms of East Asian financial integration, was the East Asian financial crisis of 1997-1998. It had two immediate consequences.[10] First, because no Asian organisation was able to provide support to any Asian state it led ‘to the irony that Indonesia, South Korea and Thailand faced an invasiveness towards national policymaking, especially through credit conditions, that was contrary to all ASEAN precepts.’[11] This experience caused financial cooperation to replace trade cooperation as the number one regional priority. To this day, the changes to domestic policies which the IMF forced upon countries as the price of the bail-outs, and the profound extent to which the IMF initially misdiagnosed the causes of the crisis, are deeply resented throughout the region.

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[8] Asian Development Bank, 'Emerging Asian Regionalism', available at <http://aric.abd.org/emergingasianregionalism/>.

[9] David Cowen & Ranil Salgado, ‘Globalization of Production and Financial Integration in Asia’, in David Cowen, Ranil Salgado, Hemant Shah, Leslie Teo & Alessandro Zanello (eds.), *Financial Integration in Asia: Recent Developments and Next Steps*, (2006) IMF W orking Paper No. 06/196. These findings have been confirmed by recent research by Arner, Lejot and Wang, see D Arner, P Lejot and W Wang, *Assessing East Asian Financial Cooperation and Integration*, AIIFL Working Paper No 5, March 2009, available at <www.aiifl.com>.

[10] Jennifer Amyx, ‘A Regional Bond Market for East Asia? The Evolving Political Dynamics of Regional Financial Cooperation’, Pacific Economic Paper No 342, 2004, Australia-Japan Research Centre, Asia Pacific School of Economics & Government.

[11] Arner, Lejot and Wang, *supra* note 9, 13.

Secondly, it brought into being the ASEAN + 3 grouping, comprised of the ten ASEAN nations plus China, Japan and Korea. ASEAN + 3 had its first summit in Kuala Lumpur in December 1997.[12] In a short time frame, ASEAN + 3 supplanted APEC as the principal economic organisation within the region.[13] Since then ASEAN + 6 (which includes Australia, India and New Zealand) has been developed, in part at the urging of smaller states seeking counterweights to the potential influence of China, and to a lesser extent, Japan.[14]

In the immediate aftermath of the East Asian crisis in 1997 Japan offered to fund the establishment of an Asian Monetary Fund, but the idea met stern opposition from the United States ('US') and the IMF, and a lack of support from China, and was dropped.[15] In its place, the much less ambitious Chiang Mai Initiative was pursued, a series of bilateral commitments by which regional nations committed to make bilateral swap arrangements and security repurchase agreements available to each other in times of need.

Over time the size of the bilateral swap arrangements were steadily expanded, while the potentially useful repo arrangements were ignored and never really used. This slow trend received a huge boost in February 2009 when the size of the swap agreements were increased by US$40 billion to US$120 billion in an agreement among ASEAN+3 finance ministers known as the Multilateralised Chiang Mai Initiative ('MCMI'). China, Japan and Korea are to provide 80% of these commitments, with the balance to come from ASEAN nations. Recent research suggests that the pre-2008 bilateral swap agreements were used in broadly efficient ways.[16] The MCMI should be far more efficient and effective, because for the first time the commitments will be multilateral, not bilateral.

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[12] Amyx, *supra* note 10.

[13] Arner, Lejot and Wang, *supra* note 9, 23.

[14] Ibid, 16.

[15] Amyx, *supra* note 10.

[16] E Kohlscheen and MP Taylor, 'International Liquidity Swaps: Is the Chiang Mai Initiative Pooling Reserves Efficiently?', (2008) 13 *International Journal of Finance & Economics* 323, 330.

Under the MCMI, Indonesia would be able to draw, as of right, about five times as much as under their official IMF reserve tranches (although in practice the IMF often exceeds these official levels of lending) and the Philippines six times as much as the official IMF commitments.[17]

For the first time, once the commitments made in February this year are implemented, regional nations will have what they needed in late 1997: a credible alternative to the credit lines extended by the IMF. However, the MCMI credit lines are not genuine alternatives, because 80% of the amounts available for drawing thereunder are not available unless a nation has an IMF program in place. In this case therefore, even if the MCMI had been in place in 1997, 80% of the funds could not have been disbursed when most needed, in a timely fashion, as IMF negotiations dragged on for months.

The apparent reason for conditioning MCMI credit upon an IMF program is that so far the CMI has not had any real surveillance capacity in place. The commitments made in February this year address this issue: ‘An independent regional surveillance unit will be established to promote objective economic monitoring’.[18]

It is easy to be optimistic about the MCMI. Yet it is today nothing more than a series of commitments, by an organisation, ASEAN, which doesn’t have a strong record of turning commitments into concrete achievements. The temptation to excessive optimism is large, because the MCMI is so needed, and the institution to which it would logically be the precursor, so important.

For a series of substantial credit lines coupled to a serious surveillance (and thus advice-giving) capacity is very close to a monetary fund, in this case, an Asian Monetary Fund. And it is the prospect of an Asian Monetary Fund that excites the imagination of those who care about the region, and its potential to contribute to global prosperity.

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[17] Ibid, 324.

[18] Report from the Finance Ministers of the ASEAN+3 to Heads of States, Feb 22, 2009, available at <http://www.aseansec.org/22157.htm>.

So the first step is to temper our optimism and recognise that the realisation of the MCMI commitments is, given ASEAN's track record, likely to take some years. Its success will require a willingness to either share sovereignty or to allow one state to design and lead the initiative,[19] and there is precious little in the history of ASEAN, in the 42 years since its inception, to suggest either of these paths will be anything but difficult.

Still these are sound reasons to explore, analyse and invest intellectual capital into the idea of an Asian Monetary Fund, not to dismiss it as unlikely to come to pass.

An Asian Monetary Fund

The nations of East Asia have enjoyed decades of extraordinary and sustained growth. For over 20 years China has grown at an average rate above 9%, Malaysia, Singapore and South Korea have all grown at annual average rates above 6%, and Taiwan and Thailand at 5.5% and 5.9% respectively.[20] When Japan was outperforming the world, from 1950 to 1965, its economy expanded on average at over 10.4% per annum.[21]

China is today the second largest economy in the world in purchasing power parity ('PPP') terms, the terms that economists generally accept are best used for comparative purposes, and the fourth largest economy in unadjusted US dollar terms. China's GDP on a PPP basis in 2008 was $7,916 billion and its per capita GDP on the same PPP terms was $5,963. This compares to $14,625 billion and $46,859 for the US.[22]

If the same policies had worked in each of these East Asian nations and differed from those of the Washington Consensus we would have a neat, simple story. But real life is

[19] Arner, Lejot and Wang, *supra* note 9, 49.

[20] Jayati Ghosh, 'China and India: The Big Differences', available at <http://www.networkideas.org/news/aug2005/news25_China_India.htm> accessed on March 3, 2009. Statistics for 2006-2008, CIA Factbook, < https://www.cia.gov/library/publications/the-world-factbook/>; except for statistics for Taiwan, which are from *Key Indicators for Asia and the Pacific 2008*, Asian Development Bank. Statistics for 1995-2005 from *Key Indicators for Asia and the Pacific 2008*, Asian Development Bank. Statistics for 1989-1994, *World Outlook 1995* Economist Intelligence Unit; and for 1987-1989, *World Outlook 1993*, Economist Intelligence Unit.

[21] K Beida, *The Structure and Operation of the Japanese Economy* (1970), 12.

[22] International Monetary Fund, *World Economic Outlook*, July 2009.

rarely neat. Indeed, the inherent and deeply embedded diversity of nations is part of the problem with the Washington Consensus – its one-size-fits-all mindset, in truth fits very few countries.

The policies that have delivered success to different East Asian nations over time have varied, considerably, from each other but one of the commonalities has been a much larger role for government in most of these countries than is permitted under the Washington Consensus. Hong Kong (treating it as a separate economy for these purposes) has followed Washington Consensus policies fairly closely, but it is the only East Asian country to do so consistently.

China has followed the classic development path of moving from an agriculture-based economy into manufacturing, initially simple manufacturing such as clothing and footwear, and then ever more sophisticated manufacturing, to the point that today China is the 'factory for the world', the way the North of England was in the early years of the industrial revolution. The 'final' stage on this classic path, followed by developed countries, is the further transition into a services-based economy.

For most of the past 25 years China has been a command economy. Even today China is perhaps best described as a soft authoritarian system. Certainly it is a very different political system to the democracies of most East Asian nations. For an example of the role of the state in China's economy consider that, as recently as 2004, state-owned enterprises accounted for over 50% of China's GDP and over 40% of its exports.[23]

These different paths and systems have been supported and reinforced by the differences between the financial systems in each country. China has retained state control of its financial sector and has used this control to manage the economic cycle and to direct funds to priority sectors of the economy, precisely as it is doing today to combat the Global Financial Crisis ('GFC'). Most other East Asian nations have relatively low levels of state ownership generally and of their financial sector in particular.[24] Accordingly,

[23] Ghosh, *supra* note 20.

[24] Ibid.

their financial sectors have not provided government with a tiller with which to direct, and control, the economy as has China's.

China has invested significantly in education of late, and is increasing this investment rapidly. According to Premier Wen Jiabao's state-of-the-nation address in March, 2008, the central Chinese government quadrupled health spending in 2007 and lifted spending on education by 76%. The Premier promised to lift health spending a further 25% and education spending a further 45% in the next year, and also promised steep increases in social welfare spending. These expenditure increases were underpinned by sharp increases in government revenues, up nearly 35% in 2007.[25] The GFC has since curtailed these revenue gains, but the direction is clear.

These funding increases in China come atop a solid base: 74% of young people of school age were in school in China in 2005.[26] Furthermore in China girls are as likely to be in school as boys, which is reflected in literacy rates. In China 99% of young women between 15 and 24 are literate.

Education is critical for growth. China's investment in education means that its deep pool of workers have been able to make the transition into manufacturing jobs because their education has enabled the transition. This large workforce is able to supply labour to manufacturing industry, and equipped to do so by massive state investment in education — not a condition for development repeated in many developing states.[27]

There are few investments that generate as strong returns for a developing nation as investing in the health and education of their children. China's current spending priorities suggests it understands this, deeply. As Susan George wrote nearly 20 years ago, 'The IMF cannot seem to understand that investing in … [a] healthy, well-fed, literate

[25] John Garnaut, 'China pours billions into social policy', *Sydney Morning Herald*, March 6, 2008, 9.

[26] World Bank, *Education at a Glance: China* available at <http://siteresources.worldgbank.org/EXTEDSTATS/Resources>.

[27] Li He, 'The Chinese path of economic reform and its implications', (Winter 2005) 31(4) *Asian Affairs: An American Review*, 195.

population … is the most intelligent economic choice a country can make.'[28] Recent IMF and World Bank practice suggests the IFIs are still to learn this lesson.[29]

The Washington Consensus Policies

The focus of the Washington Consensus policies has been to grow the debtor's economy, so as to alleviate poverty within the country and generate sufficient foreign exchange resources to service its debts. It has been taken as axiomatic that higher growth rates lead to less poverty, that higher growth rates are only possible once economic stabilisation has been achieved, and that higher growth is best achieved on the back of exports, not increases in domestic demand. The policies imposed to achieve these goals typically included:

- reductions in the budget deficit to limit inflation, and the need for foreign borrowing,
- limits on domestic credit expansion to control inflation,
- exchange rate devaluations to discourage imports and encourage exports,
- liberalisation of tariff and quota regimes, and
- a much reduced role for government and a much increased role for markets.

Other Washington Consensus policies imposed on debtors, at times, included (i) higher income and sales taxes, (ii) higher charges for state-produced goods and services such as electricity and water, (iii) privatisation of state-owned companies, and (iv) deregulation of the labour market. These policies have been criticised for their adverse effect on economic growth and their devastating effect upon the living standard of the local people, particularly the poor.[30]

[28] Susan George, *A Fate Worse Than Debt*, (New York: Grove Weidenfeld, 1990), 143, 187, 235

[29] Ross P. Buckley, 'IMF Policies and Health in Sub-Saharan Africa', in forthcoming *Global Health Governance: Crisis, Institutions and Political Economy*, Adrian Kay and Owain Williams (eds), (London: Palgrave Macmillan, August, 2009).

[30] W. Bello, *Dark Victory: The United States, Structural Adjustment and Global Poverty*, Pluto Press, London, 1994; D Green, *Silent Revolution - The Rise of Market Economics in Latin America* (London: Cassell, 1995), (Green entitled his chapter on the IMF and the World Bank, 'Poverty Brokers', at 32 et seq).

The Washington Consensus has encouraged export-led growth for developing countries.[31] However, a reliance on exports exposes developing countries to the vagaries of demand in developed and other developing countries and to the extreme volatility of global commodity prices. A better policy admits of a larger role for domestic demand-led growth. In Palley's words, '[t]his is a strategy that lifts all boats since demand growth in one country pulls in exports from others, so that all grow together.'[32] The final word on the Washington Consensus goes to Professor Hal Scott, 'there is little evidence that IMF conditions, usually requiring contractionary fiscal and monetary policies, have worked.'[33]

To understand how the IMF came to have, as its primary role, the direction of the economies of debtor nations in crisis and the implementation, therefore, of the Washington Consensus, it is necessary to understand its history.

A Brief History of the IMF

The IMF was founded, along with the World Bank, in 1945 to, in the words of its website,

> promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.[34]

This is a reasonable summary. But the website proceeds,

> Since the IMF was established its purposes have remained unchanged but its operations—which involve surveillance, financial assistance, and technical assistance—have developed to meet the changing needs of its member countries in an evolving world economy.

[31] Thomas I Palley, 'Toward a New International Economic Order: Goodbye Washington Consensus, Hello Washington Alternative', available at < http://www.thomaspalley.com/docs/articles/economic_development/new_intl_economic_order.pdf>.

[32] Ibid.

[33] Hal S Scott, 'A Bankruptcy Procedure for Sovereign Debtors?', (2003) 37 *The International Lawyer* 103, 115.

[34] International Monetary Fund Website, available at <http://www.imf.org/external/about.htm>, accessed on Sept 10, 2007.

At best, this is spin, for the Fund's purposes have changed. They changed in the 1970s when most developed countries moved away from fixed, to floating, exchange rates and the core function of the Fund, the maintenance of exchange stability, was ceded by governments to the market.

The Fund performed a useful function throughout the 1950s and 60s, which were periods of sustained growth in much of the world, but by the end of the 1970's the Fund had a much reduced mission. This all changed with the debt crisis of 1982. The crisis gave the Fund the chance to reinvent itself as the manager of developing country crises. Debtors needed new money, to at least service interest. Creditors wanted assurances that the debtor's economic policies that had contributed to the crisis had been changed, and had firm views on the need for economic austerity by countries whose debt they were rescheduling. Yet direct commercial bank involvement in the setting of local economic policies was a political impossibility. The IMF was ideally placed, as an apparently independent international financial institution, to determine and monitor the economic policies, going forward, of the debtor nations.[35]

> These policies imposed by the IMF and the World Bank, and supported by the US Treasury, came to be known as the Washington Consensus as all three bodies are headquartered in Washington, D.C. Yet these policies fly in the face of the experience of OECD countries. Britain in the nineteenth century, and the United States in the twentieth century, promoted free-trade 'because they were the most efficient producers of the highest value-added goods. They did not become so through free trade; they protected themselves for decades in order to achieve that end.'[36]

The Debt Crisis of 1982

In the early years of the debt crisis the Fund severely underestimated its magnitude and responded with ineffective policies. IMF policy prescriptions for Africa and Latin America meant the 1980s were a lost decade, in which net capital flows were northbound,

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[35] But only at the cost of resentment from within the debtor nations: remarks of Lee C Buchheit, in 'Comity, Act of State, and the International Debt Crisis: Is There an Emerging Legal Equivalent of Bankruptcy Protection for Nations?', Proceedings, Seventy-Ninth Annual Meeting, The American Society of International Law 126, 135.

[36] JG Castaneda, *Utopia Unarmed* (New York: Alfred A Knopf Inc, 1993); and see JK Galbraith, *The Culture of Contentment* (Bostodfn: Houghton Mifflin, 1992), 46.

in which infrastructure crumbled, and in which life expectancy at decade's end in Sub-Saharan Africa was shorter than at the beginning.[37]

The debt crisis was relieved for the banks by the Brady Restructurings of the early 1990s in which the loans were converted into tradable bonds at a discount, with security for the repayment of principal and some interest. The Brady process did less for the debtor nations than the banks but brought some modest relief and encouraged new capital inflows. Of importance for this analysis is that the Brady Plan was devised initially in Sao Paulo and Mexico City and then given the imprimatur and support of the US Treasury.[38] The IMF had no substantive input into crafting the only creative measure brought to bear on the debt crisis.

The Asian Crisis of 1997

Asia's was a fundamentally different crisis from the debt crisis of 1982 or Mexico's peso crisis of 1994–95 in that the great majority of the troublesome indebtedness was of the private, not the public or quasi-public, sector and it was not a crisis of over-consumption. Latin American nations had borrowed to fund government budgets. East Asian governments had not been similarly seduced. In the words of Laurence Meyer, a Governor of the US Federal Reserve System,

> By conventional standards, the monetary and fiscal policies of the developing Asian economies prior to the crisis were largely disciplined and appropriate. … consumer price inflation … was relatively subdued [and] fiscal policy also appears to have been disciplined.[39]

Asia's crisis was primarily a crisis of inadequate local prudential regulation and inadequate confidence of global capital in the region.[40] It was a contractionary crisis.

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[37] Eduard R. Bos (ed), *Disease and Mortality in Sub-Saharan Africa*, (2nd ed: VA, USA: World Bank, Herndon, 2006), 12.

[38] Ross P Buckley, 'Turning Loans into Bonds: Lessons for East Asia from the Latin American Brady Plan,' (2004) 1(1) *Journal of Restructuring Finance* 185–200.

[39] LH Meyer, *Lessons from the Asian Crisis: A Central Banker's Perspective*, Levy Economics Institute Working Paper, No 276 (Aug 1999).

[40] With the exception of Indonesia which was overly indebted and experienced a more traditional debt crisis. For more on the Asian crisis, see Ross P Buckley, 'An Oft-Ignored Perspective on the Asian

Notwithstanding all of these differences, the IMF waded into Asia imposing the Washington Consensus policies it believed had worked in Latin America in the 1980s and Mexico in 1995 – prescriptions of budgetary tightening and austerity. Austerity is always bad policy for a contractionary crisis. It is utterly ineffective in encouraging contracting economies to expand. At the time the Nobel laureate, Joseph Stiglitz, was the Chief Economist of the World Bank and he spoke out repeatedly to highlight the fundamental error in the Fund's response to the Asian crisis.[41] Joe Stiglitz was to be proven right, but when it mattered most, the IMF wouldn't listen to him.

The IMF eventually acquiesced to requests by national governments for more expansionary policy settings but by then considerable, unnecessary economic damage and human suffering had occurred. Furthermore, the Fund only eased its austerity policies. In the meantime, Malaysia had adopted more successful strategies that remain outside the Fund's kitbag of policy options.[42]

Malaysia refused IMF funding and advice and chose to chart its own way out of the Asian crisis, imposing capital outflow controls to keep foreign capital within the country, and pegging the ringgit to the US dollar.[43] Malaysia was then able to ease monetary policy and pursue expansionary fiscal policies, without being hampered by concerns about the impact of capital outflows on exchange and interest rates.

Malaysia had created as close to a controlled laboratory experiment as one gets in economics. Thailand and Korea sought to exit the crisis using the Fund's policies. Malaysia followed a different course. (Indonesia is a separate case, as its high debt levels meant it was in a different type of crisis). All three economies recovered, but Malaysia's

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Economic Crisis: The Role of Creditors and Investors', (2000) 15 *Banking and Finance Law Review* 431–454.

[41] Peter Passell, 'Critics: The I.M.F. is misguided. Skeptics: Too much rot in Asia', *The New York Times*, 15 January 1998, D2, Col 1; Reuters News, 'World Bank's Stiglitz criticises IMF on S.Korea', 17 March 1998.

[42] Ross P Buckley and Sarala Fitzgerald, 'An Assessment of Malaysia's Response to the IMF during the Asian Economic Crisis', (2004) *Singapore Journal of Legal Studies* 96.

[43] Ibid.

recovery was more rapid, and its poor harmed far less.[44] As Kaplan and Rodrik put it, 'compared to IMF programs, ... Malaysian policies provided faster economic recovery… smaller declines in employment and real wages, and more rapid turn around in the stock market.'[45]

Yet the Fund's mistakes in East Asia, so clearly highlighted by Malaysia's taking the road less traveled, paled in comparison to its egregious errors in Argentina.

Argentina's Implosion in 2001

From 1991 to 1998 Argentina prospered as its GDP per capita increased 44% and inflation was under control.[46] Argentina improved its banking system, more than doubled its exports, privatised a broad range of industries, experienced significant growth in oil and mineral production and achieved record levels of agricultural and industrial output.[47] It was the darling of the IMF and global financial markets and toasted as 'the best case of responsible leadership in the developing world.'[48]

Nonetheless in late 1998 Argentina entered a severe recession caused by excessive borrowing to support general government expenditure, the peg of the peso to the US dollar, and Argentina's endemic corruption.[49] The recession was magnified by massive capital flight, so that the government had to impose harsh caps on withdrawals from bank

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[44] Ibid.

[45] Ethan Kaplan and Dani Rodrik, *Did the Malaysian Capital Controls Work?* National Bureau of Economic Research Working Papers (2003), available at <http://papers.nber.org/papers/W8142>.

[46] Miguel Kiguel, 'Structural Reforms in Argentina: Success or Failure?', *Comparative Economic Studies*, (Summer 2002) XLIV(2) 83, 84; percentage calculated from Figure 1.

[47] Ibid at 100–101. This is not to suggest that the privatisations were not deeply problematic. It is always a profound challenge to realise appropriate prices for the privatisation of major businesses and assets in emerging markets nations. The range of potential purchasers is narrow, overly favorable prices for well-connected purchasers are likely, and scrupulous and rigorous public accountability procedures are rarely present. It is likely many of the privatisations of the 1990s in Argentina were at a deep undervalue.

[48] 'Chaos in Argentina', *The Nation*, January 21, 2002, 3; 'Argentina: A Poster Child for the Failure of Liberalized Policies? Interview with Lance Taylor', *Challenge*, Nov–Dec, 2001, 28.

[49] Ross P. Buckley, 'Do Cry for the Argentines: An Analysis of Their Crisis', (2003) 17 *Banking & Finance Law Review* 373.

accounts, and eventually close the banks. Still the crisis deepened when the IMF refused to extend further credit to the nation in 2001, believing its economic programs to be unsustainable. As commercial lenders followed this lead, Argentina was forced to default on its external debt of some US$132 billion.

Argentina was exceptionally resolute in its negotiations with its external creditors and refused to accept conventional levels of debt relief. President Kirchner refused to service the debt from the 'suffering and hunger of the people'. He had good grounds: Argentina's poverty rate, 27% in 1999, by 2003 had doubled to 54.7%; per capita GDP, US$7,800 in 1999, by 2004 had fallen to $3,800; and debt that represented 47.4% of GDP in 1999, by 2004 was 140% of GDP.[50]

In early 2005, 76% of Argentina's creditors accepted its offer to exchange its debt for bonds at the unprecedented discount of some 66 per cent on a net present value basis. Argentina emerged from its default on the most advantageous terms ever secured by a middle-income country in a debt restructuring. In the words of *The Financial Times*, 'Argentina gambled, and the gamble paid off.'[51]

In contrast, the IMF emerged with its credibility in tatters. Never before had a country that had so faithfully followed the Fund's policies collapsed so severely, never before had the Fund's image been so badly damaged by a sovereign default.

An Asian Consensus

The developed nations should be grateful that China and the other nations of East Asia have ignored IMF advice, and take their own paths, because for decades the stellar economic growth of East Asia has lifted that of the world. China's capacity to produce manufactured goods, clothing and other items ever more efficiently and cheaply has kept a lid on inflationary pressures in virtually all developed economies. For Australia and other minerals exporters China's growth has provided a massive market for minerals and

[50] JF Hornbeck, *Argentina's Sovereign Debt Restructuring*, CRS Report for Congress, RL 32637, Oct 19, 2004, available at <http://fpc.state.gov/documents/organization/39301.pdf>.

[51] 'Argentina sets a dangerous precedent: The IMF should set tough conditions for further lending', *The Financial Times*, March 7, 2005, 20.

other commodities. The rise of East Asia underpinned global prosperity in the two decades leading up to the GFC.

East Asia is uniquely placed in terms of domestic savings rates and foreign exchange reserves. China and Japan hold nearly 20% each of worldwide official foreign currency reserves.[52] For many years, China and Japan have been the principal buyers of US Treasury bonds. The Chinese and Japanese have saved and lent, so Americans can borrow and spend.

China has amassed massive foreign exchange reserves, on the back of an undervalued currency. These serve as splendid insurance against global financial instability. Recent research suggests that while China is clearly manipulating the value of its currency, it is not in breach of its obligations under the Articles of Agreement of the IMF or the various WTO treaties.[53] A more integrated East Asian region could follow China's lead, particularly if greater integration led to China's, Japan's and South Korea's high savings rates serving as a source of capital for the region. A nation cannot fix the value of its currency if it needs global capital. It is only the independence that high domestic savings rates give a nation, that allow the long-term manipulation of the value of its currency. China, Japan and South Korea could serve as a source of capital to the entire East Asian region and thus give to the region considerable exchange rate autonomy.

The success of East Asia highlights the weaknesses in the Washington Consensus policies. China and India are two very different nations, with different political systems, development paths, financial systems, and economic policy settings. Yet both nations have far outperformed those implementing Washington Consensus policies. It is arguable that China and India have unique advantages not available to other developing nations. In China, its massive supply of relatively educated, cheap labour and its huge domestic

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[52] Kohlscheen and Taylor, *supra* note 16, 323.

[53] Bryan Mercurio and Celine Sze Ning Leung, 'Is China a 'Currency Manipulator'?: The legitimacy of China's exchange regime under the current international legal framework', forthcoming *The International Lawyer.*

market which China has used adroitly to lure inbound FDI (and ensure high technology comes along with it). In India, the widespread facility with the English language, the English common law legal system and other institutions, and, its tradition of excellence in mathematical and scientific education.

However, these arguments founder when one considers that of the two nations, India's policies are much closer to those of the Washington Consensus than China's. Government has a much smaller role in the Indian economy than in China's. The market is the major allocator of financial and other resources in India, much less so in China. Yet China has consistently outperformed India, and, given the increased investment in its human capital which China's economic growth has made possible, it is likely to continue to out perform India in the foreseeable future.

Conclusion

For years Western experts have been predicting that China's high growth rates could not be sustained.[54] The weakness of its institutions, such as the rule of law and independent courts, mitigate against sustained growth in Western eyes. But China's continued growth, far beyond the limits the experts were certain would constrain it, suggests that China may have crafted its own paradigm in which the lessons of institutional economics need to be revised. Whether that system is transferable to other nations, with different work ethics and cultures and levels of entrepreneurship is another matter. What is clear is that Washington Consensus policies have not worked in most countries to which they have been applied, and the policies that engendered such dramatic and sustained periods of growth in China, Japan, South Korea, Singapore, Malaysia, Taiwan and other countries are quite different to those of the Washington Consensus.

[54] Anne O. Krueger, First Deputy Managing Director, International Monetary Fund, 'China and the Global Economic Recovery', Keynote Address to The American Enterprise Institute Seminar, Washington D.C., January 10, 2005; James K. Galbraith, 'Sustainable Development and the Open Door Policy in China', UTIP Working Paper number 16, May 5, 2000; Eswar Prasad, Division Chief, Asia and Pacific Department, IMF, 'Growth and Stability in China: Prospects and Challenges', *Harvard China Review*, Annual Conference, Cambridge, MA, April 17, 2004; and Robert Dekle, 'The Chinese Economy: Perspectives from the Japanese Manga' 2005 8(2) *Harvard Pacific Law Review* 47, 49.

An Asian Consensus would, logically, be an amalgam of the policies that have worked to lift massive portions of East Asia's population out of poverty: policies that allow a larger role for government, that promote domestic demand-led growth as well as export-led growth, and that prioritise inbound equity investments over debt, and investment in the education and health of the local people over the repayment of foreign debt.

An Asian Monetary Fund could differ in many ways from the International Monetary Fund and serve to pioneer new approaches to the development challenge.

A decade ago, Eichengreen and Bayoumi concluded about East Asia that 'there is little sign, comparable to the evidence which has existed in Europe for nearly 50 years, of a willingness to subordinate national prerogatives to some larger regional entity.'[55] A decade later this is less true than it was, but is still not wrong.

So the road to an Asian Monetary Fund will likely be long, and difficult. But the first major steps have been taken. An AMF represents the chance to move away from a development model that is focused primarily upon ensuring poorer nations are able to service their debts and move towards a model that is genuinely focused upon the development of the nations themselves and their people. The people of East Asia deserve nothing less.

[55] B. Eichengreen and T. Bayoumi, 'On regional monetary arrangements for ASEAN', paper presented at an international conference on exchange rate regimes in emerging market economies, Dec 17-18, 1999, Tokyo, Japan.