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Headline: Asean needs to step up its financial act

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While much stronger now compared to when the Asian financial crisis struck, the grouping needs to strengthen its safety net against another crisis

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The 10 member-economies of Asean have made big strides in achieving financial stability since the Asian financial crisis 20 years ago. A series of economic and banking and financial sector reforms carried out in the aftermath of that crisis helped enhance the economic and financial resilience of the regional grouping.

The region came through the 2008 global financial crisis and the "taper tantrum" of 2013 relatively unscathed. Today, Asean is seen as one of the most dynamic regions in the world. The International Monetary Fund (IMF) expects the group to grow by more than 5 per cent a year on average, over the next two years, far higher than the roughly 3.5 per cent predicted for the global economy.

Over the past two years, however, there has been an increased sense of vulnerability in the region. As global economic growth slowed and the volatility of global capital flows persisted, questions have been raised about Asean's ability to shield itself from another major financial storm, should such a storm break out again.

Reflecting the group's heightened concerns about regional financial instability, Singapore and Indonesia signed a US$10 billion (S$13.5 billion) swap agreement last November to lend each other US dollars in the event of a currency crisis. It was the first bilateral swap agreement among Asean members since the group was established over 50 years ago.

In theory, Asean countries are much better positioned today than they were 20 years ago to weather a financial crisis. Not only do they possess sounder economic fundamentals, they are also protected by a stronger financial safety net, in the form of the Chiang Mai Initiative Multilateralisation (CMIM), a US$240 billion swap agreement among the Asean plus-3 countries (the three being China, Japan and South Korea).

The CMIM provides a much bigger pool of resources than the US$2 billion Asean Swap Agreement (ASA) that the region had prior to the Asian financial crisis in 1997. The absence of an adequate region-wide swap agreement arrangement was seen as one reason why the Asean currencies collapsed so quickly in 1997.

Unfortunately, there is a great deal of unease among Asean members about the effectiveness of CMIM as a mechanism for regional crisis prevention and resolution.

Specifically, there are concerns that the interests of the CMIM may not be aligned with those of the Asean countries. As the major shareholders providing 80 per cent of the fund, it is the plus-3 countries which are the principal decision makers in the CMIM. However, the region's experiences in recent years have shown that they are exposed to shocks that are distinct from those affecting the plus-3 countries.

Moreover, there is a feeling that the plus-3 countries may not be sufficiently sensitive to Asean's political and economic vulnerabilities and the decisions they make may not adequately address the region's needs.

Another major concern that Asean has is that the CMIM can approve only the first 30 per cent of the funding that a country in crisis needs. The remaining 70 per cent is subject to the IMF approval process. Many Asean countries consider the link to the IMF programme a stigma because of the controversial actions the IMF took during the Asian financial crisis, making it politically difficult for them to request funding from the CMIM.

This means that an Asean country faced with a temporary balance of payments shock may have no recourse to sizeable liquidity support until it is too late, since the bulk of the CMIM funds are linked to the IMF programme. In effect, the stigma has reduced the CMIM to a largely non-operational role.

The CMIM's track records so far have been far from sterling. In the past 10 years of volatile global capital flows and occasional crises, the CMIM has proved to be ineffective in helping Asean. For example, in spite of a genuine need in some Asean members for emergency funding during the so-called taper tantrum in 2013, the CMIM facility was not utilised at all.

When a financial crisis erupts, Asean needs a regional financial arrangement that is fully under its control – just like a central bank needs to have control over its own international reserves – as the first line of defence.

It is time Asean built its own crisis prevention and resolution arrangement as an additional financial safety net to that provided by the CMIM. The rebuilding could begin with a reconstructed and substantially strengthened Asean Swap Agreement, with the governing structure made up of representatives from Asean countries only.

Asean governments should take the bold step of increasing the size of the Asean Swap Agreement to at least US$50 billion. Asean should also reclaim its centrality in decision-making, with the decision to activate the ASA fund to be made by Asean countries independent of the plus-3 countries.

To be sure, economic surveillance and policy dialogue will still be needed to support the ASA – but this can be done through the Asean + 3 Macroeconomic Research Office that was set up as part of the CMIM.

The new ASA could be designed as a liquidity facility to address primarily liquidity shocks and it should be viewed as playing a complementary role to the CMIM. In the event of a liquidity shock, the ASA would provide the second line of defence after the country's own reserves, with the CMIM forming the third line of defence.

We believe that with Asean shouldering the initial funding responsibility in a crisis, it will greatly facilitate the subsequent funding from the CMIM.

A strengthened ASA is neither unrealistic nor infeasible. Compared with the pre-Asian financial crisis period, Asean countries today are much stronger in their international reserves positions. Together, the 10 member-countries have built up a formidable pool of reserves of over US$900 billion, relative to the mere US$164 billion they had in 1997 prior to the Asian financial crisis.

A stronger Asean-centric mechanism for crisis prevention and crisis resolution will signal to the world of the group's commitment to play a bigger role in securing its own economic future and prosperity.

Asean countries have made remarkable progress in economic growth and development over the past 20 years. It would be regrettable if its journey of continuing economic growth were derailed by another financial crisis. It would be a shame if such a crisis happens because of the absence of a strong and credible crisis prevention and resolution mechanism in the region.

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