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Economic Crises and Regional Institutions

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Introduction

Regionalist movements are intimately connected to economic and financial crises. Most of the financial crises of the last four decades have had a strong regional dimension. We identify them as the "Latin American debt crisis," the "European currency crisis," the "Asian financial crisis" because their impact has been geographically concentrated. Crises call into question the adequacy of multilateral arrangements for prevention and stabilization and, under certain circumstances, galvanize support for proposals to strengthen regional agreements and institutions. Once in place, regional arrangements can shield countries against the adverse effects of global financial turbulence, if they are well designed.

Our understanding of regionalism would benefit from more systematic analysis of its relationship to crises. This chapter examines the extent to which economic crises help or hinder the development of more effective regional institutions and addresses the determinants of institutional evolution and design in the Asian region. First, it conducts a structured comparison of the most important region-wide crises over the last four decades and their impact on regional institutions. By asking similar questions in each case, we can draw generalizations about the conditions that are conducive and averse to institutional building. Second, the chapter elaborates on aspects of cases that speak to key points in the present Asian discourse on regional institutions. While considering a common set of factors, the treatment here will sometimes explore instructive aspects of cases even when they might not fit with a common template.

After comparing these crises, the chapter concludes that five conditions are especially important in facilitating a constructive regional response to a crisis: a significant degree of regional economic interdependence (market integration); an independent secretariat or intergovernmental body charged with cooperation; webs of interlocking economic agreements; and, as elements of the multilateral context, conflict with the relevant international organization (such as the IMF) and acceptance by the United States of regional integration. These findings are further supported by the European sovereign debt crisis more recently. The chapter does not argue that regional movements can only be generated by crises, but that these conditions are conducive to institution building in response to them. Asian regionalism would be favored in the future by shocks that are external to the region, rather than coming from a member state, and responses from multilateral institutions that are averse to Asian preferences. Asian regionalists would be well served by using crises to ratchet up governments' commitments to secretariats and intergovernmental bodies, establishing linkages among economic issue areas, and forging cooperation with multilateral institutions.

The following section discusses the nature and definition of "crisis" and "institution," central concepts in this study. The third section addresses the causal links between crises and institution building, as well as the factors that condition regions' responses to crises. The fourth section presents five crisis cases. The fifth section draws conclusions from the comparison of cases and identifies conditions favoring further institution-building in Asia and strategies that advocates of Asian regionalism might adopt.

Defining the Concepts

The Oxford English Dictionary's first definition of "crisis" is "a time of intense difficulty or danger." Original usage in English meant "a time of decision" and has evolved toward "an emergency requiring decision." The concept is employed widely, though inconsistently, in comparative politics, international relations and political science generally. (See for example, Allison and Zelikow 1999, as well as Phillips and Rimkunas 1978, Svensson 1986, Goertz 2006) General modern English usage coincides with our current use with respect to economics and finance: *an economic or financial emergency that requires a rapid policy response*.

In practice, this label applies to major declines in the value of national currencies and financial assets, the bankruptcy of financial institutions, collapse of financial markets, and macroeconomic recessions or depressions. The Latin

American debt crisis of the 1980s, European exchange rate crisis of 1992–93, Mexican peso crisis of 1994–95, Asian financial crisis of 1997–98 fall under this definition. Also falling under this definition are major shifts in currency values and conflicts over payments balances and macroeconomic adjustment, such as the "Nixon shock" of 1971, and major shifts in commodity prices and supply, such as the "oil shocks" of the last four decades. Each of these events forced decisions by governments that had ramifications for international cooperation, including cooperation on a regional basis.

Crises are characterized by phases. First, crises are preceded by periods of normality, an equilibrium during which economies and the political relationships among actors and institutions are relatively stable. Tranquility nonetheless masks the gradual buildup of debt, for example, that becomes ultimately unsustainable. Second, the acute phase is initiated by a spark that triggers a cascading series of events, such as collapse in financial markets. Third, policymakers struggle to respond, during which time they might broker or be subject to realignments in international and domestic politics. Fourth, the crisis is resolved and the political economy returns to a new and usually different equilibrium—until the next crisis occurs. (Compare to Gourevitch's (1983) staging of crises, pp, 21–22, and Frieden's (1991) stylized evolution of crisis politics, pp. 35–38.) Construction of regional institutions could occur during the response phase or in the new equilibrium.

Consider now the concept of "institutions" somewhat more carefully. The notion is defined differently across the various subfields of political science and economics.[1] The definition chosen for this chapter, guided by the overall purpose of the book, is broad but not all encompassing. The term "institution" is employed here to include *(a) explicit, formal commitments and organizations and (b) common processes and informal networks among governments that facilitate cooperation*. The term can thus refer to ASEAN+3, the Chiang Mai Initiative or Economic and Monetary Union, as well as regular official meetings, peer review and surveillance processes. The concept is broader than simply a formal regional bureaucracy but not so broad as to include norms and expectations. Nor does the term include private-sector networks and transnational political and technocratic alliances.

Crises as Catalyst for Regional Institutions

Consider next the reasons we might expect crises to stimulate national governments to construct regional institutions and the background conditions that explain why some regions respond to crises in this way while other regions do not.

Causal links

If crises are exceptional moments of political realignment and policy shift that can be institutionalized in bargains and arrangements that define a new, durable equilibrium, what, precisely, are the *mechanisms* of the change with respect to regional institutions? In principle, we can posit several causal channels.

1. Political demand. Crises give rise to demands for state action to protect corporations, banks, private sector groups and social groups from economic dislocation. These demands operate through domestic politics, but satisfying them is sometimes more effective when coordinated regionally, which regional institutions facilitate.
2. Preference reshuffling. Crises can change the material bases of domestic coalitions; destruction of wealth and shifts in competitiveness empower some firms and sectors and weakens others. When these shifts motivate or empower transregional groups, they promote cooperation. When crises affect states within a region similarly—which is not always the case—that can foster cooperation through the convergence of preferences. Crises can raise regional cooperation higher on the political agenda of national leaders.
3. Political realignment and regime transformation. Crises can stimulate the realignment of domestic social groups (Gourevitch 1983) and transform domestic political regimes. Sometimes, such changes can make governments more predisposed to trade off national autonomy for the benefits of regional cooperation. Crises sometimes stimulate transitions to democracy (Haggard 2000) and democracies might be more inclined to international cooperation.
4. Network reinforcement. Crises stimulate communication, discourse and negotiation among government officials and international civil servants within a region, reinforcing elite intergovernmental networks that can support regional integration in a subsequent stage. (Calder and Ye 2004)
5. Leader agency. Whereas in normal circumstances, heads of government and their ministers will often be beholden to important constituencies and pressure groups, crises alter the constraints upon them. Crises typically impose strong financial and economic constraints that limit the policy options of governments. By discrediting some ministries and agencies and by forcing quick, unpleasant choices, however, crises can liberate leaders from interest-group and bureaucratic politics-as-usual, temporarily giving them more political room for maneuver.[2]

Two frequent candidates have not been included in this list: ideational convergence and power shift. One might be tempted to argue that crises stimulate reassessment of policies and institutions leading to a convergence of analytical beliefs and frameworks that facilitate institutionalization. More often, in my observation, crises generate vigorous debate over causes and widen, rather than narrow, the range of alternative views.

One might also hypothesize that, when they affect countries differently, crises can alter the relative power position of states within a region. The Asian financial crisis of 1997–98 shifted influence within East Asia away from Japan and toward China, for example. (Pempel 1999: 228–232) However, this effect is almost always a temporary acceleration or retardation of an underlying structural trend. Rapid changes in relative power positions can discourage institutionalization because the ascendant state will anticipate a more favorable institutional bargain if it defers agreement.

Background Conditions

Crises are not the only or necessarily even primary determinants of regional institution building. They occur against the background of existing circumstances which configure a region's predilection toward regionalism. Moreover, crises cannot stimulate institution building directly; instead, national officials, international civil servants and pre-existing regional forums construct them. These officials in turn exercise partially independent choice, agency. Whether any given crisis generates institution building thus depends on a set of third variables.

The various approaches to regional integration—neofunctionalism, institutionalism, realism, constructivism and domestic politics and epistemic approaches—would each advance candidates for this set.[3] Those candidates include pre-existing regional institutions, intergovernmental and transnational networks, norms, ideas, regional dominance, intra-regional rivalry, linkages to political integration, security externalities and geopolitics. In previous work, I have stressed the role of institutions and preferences in the context of multilateral arrangements. The source of the shock (whether internal or external to the region) and the response of the multilateral regime strongly condition the regional response to crisis and conflict.[4]

Drawing on several of these theoretical perspectives, we can expect that a crisis will stimulate the building of common institutions within a region in the presence of:

1. a secretariat that is charged with fostering cooperation;
2. substantially integrated markets for goods, services and capital;[5]

3. functional linkages to pre-existing agreements in related economic areas;[6]
4. a single dominant country within the region;
5. preferences that conflict with the relevant multilateral institution; and
6. a benign posture toward regionalism on the part of the United States.

Conversely, in the absence of these background conditions, we would not expect crises to produce institution building.

Alternative Outcomes

There is no *a priori* reason to expect that crises cannot also weaken or destroy regional institutions, just as they might national or multilateral institutions. The 1992–93 crisis in the Exchange-Rate Mechanism of the European Monetary System witnessed the ejection of the British pound and the Italian lira from the regime and a formal widening of the bands of exchange rate fluctuation. A constructive response by European governments, though ultimately forthcoming, was by no means inevitable. In the absence of these background conditions, counterfactually, we might have observed subsequent institutional *decay*.

To list the set of possible outcomes comprehensively, we must acknowledge that it is also possible in principle that a crisis might have *no effect* on regional institutions. One variation on this outcome would be an apparent effect that proves transitory, leaving the degree of institutionalization unchanged in the long term. "No effect" can be treated as the null hypothesis and the cases of crises can be used to test whether outcomes differ substantially from it and, if so, in which direction.

Finally, in cases where crises contribute to the creation or strengthening of regional institutions, we would expect this to apply primarily to a specific set of institutions—those that provide defenses against crises or the means to manage them. In response to a balance-of- payments crisis, for example, we might expect states to create balance-of-payments financing facilities and bodies and processes to activate them—not free trade areas, customs unions or other regional arrangements unrelated to the crisis. We expect the functional form of the crisis to dictate the type of institutional response.

Cases of Crises and Regional Responses

Consider now the prominent cases of economic and financial crisis in the last four decades. We begin with the treatment of Europe and the process of monetary integration, which was punctuated by a number of crises over the span of several decades. We then consider specific crises and responses, beginning with the Latin American debt crisis of the 1980s, then the Mexican peso crisis of 1994–95, the Asian financial crisis of 1997–98 and the Asian dimension of the 2007–2009 crisis.

European Monetary Integration

A substantial literature addresses the political economy of exchange-rate stabilization, macroeconomic convergence and the creation of the euro. Authors emphasize various factors as the driving force for European monetary integration: integration of markets, German dominance, domestic politics, intergovernmentalism, linkage politics, institutions, economic ideology, geopolitics and political integration.[7] My own contribution emphasizes the international monetary system and disturbances transmitted through it as the context for monetary integration. This approach gives pride of place to conflicts between Europe and the United States over exchange rates, the balance of payments and macroeconomic adjustment as incentives for European cooperation. (Henning 1998) Because several of these episodes were full-blown crises, a review of that approach is suitable here.

International monetary conflict and turbulence provides strong incentives for groupings of vulnerable states to consider regional monetary cooperation in order to create an "island of monetary stability." Regional arrangements help countries limit the shifts in intra-regional exchange rates, deflect pressure for policy adjustments, and perhaps even exercise countervailing pressure on a dominant state outside the region. Beginning in the 1960s, the United States ran large current account deficits during several episodes, pressured the governments of surplus countries to stimulate their economies, and encouraged depreciation of the dollar in order to persuade them to comply and otherwise achieve adjustment. Confronted by the appreciation of their currencies, the surplus countries, which frequently included Germany, could expect a drop in exports, growth and employment—which reinforced U.S. demands for macroeconomic stimulus.[8]

In the teeth of the conflict, European governments parried, deflected, but ultimately often accommodated U.S. pressures for macroeconomic adjustment. The recurrence of U.S. pressures and international monetary instability sustained the interest on the part of targets, which often included Germany, in developing regional arrangements as defensive mechanisms. After periods of transatlantic monetary conflict, therefore, Europe responded with initiatives for currency cooperation. Conversely, during periods of transatlantic monetary tranquility, the impetus for monetary integration tended to flag.

The historical narrative, in brief, begins with the Bretton Woods regime, the context for the origins of the European Community. Because that regime stabilized European cross rates at the same time that it stabilized European currencies against the dollar, monetary matters were virtually off the agenda of early European integration. As the Bretton Woods regime experienced a succession of currency crises in the 1960s and then collapsed altogether in the early 1970s, however, the Europeans developed plans for currency cooperation. If the Bretton Woods regime had remained intact, European governments would not have sought regional exchange rate stabilization.

As much of the rest of the world went to flexible exchange rates during the 1970s, Europe experimented with the "snake." Conflict with the Carter administration during 1977–78 persuaded German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing of the benefits of tightening the European monetary regime. They thus created the European Monetary System (EMS) in 1979. Conflicts with the United States during the Plaza and Louvre accords in the mid-1980s and during 1990 and 1991 helped to reinforce the process leading to the Maastricht treaty.[9] (We consider subsequent episodes in the sections below.) Exchange rate and balance of payments crises were thus integral to the process of European monetary integration.

There were large and sometimes heated conflicts among countries within the region, of course. Member states exhibited considerable variation in their macroeconomic preferences and disagreements over the direction and design of common monetary arrangements. Germany was famously devoted to monetary orthodoxy and fiscal conservatism to restrain inflation while benefiting from external demand and export-led growth. France and Italy pursued monetary and fiscal activism in efforts to sustain domestic demand and employment. Conflicts with the United States served to highlight the benefits to macroeconomic convergence in Europe as a route to monetary integration.[10] U.S.-generated disturbances did not extinguish intra-European disputes, but they increased the payoff to intra-European accommodation.

Conflict and crises were not the only important factors, of course. Three background conditions were particularly important also. First, Europe had a substantial degree of intra-regional market integration. In the mid-1970s, intra-European exports were about 45 percent of total European exports and about 8 to 9 percent of European GDP. Cross-rate shifts could therefore disrupt a significant amount of trade and investment. Second, Europe had a set of common policies with respect to agriculture, trade, competition, development and structural cohesion and was almost continuously negotiating enlargement of its membership. Political and institutional linkages among these policies facilitated a regional response to crises. Third, the institutional structure of the European Community had established forums for ministers and heads of government, regularized meetings among them, a committee of central bank officials responsible for operating currency arrangements, and a Commission with strong bureaucratic incentives to further integration.

For crises to have a sustained effect on regional integration, member states must not abandon post-crisis monetary arrangements during periods of tranquility. By creating organizational actors and political bargains, governments institutionalize the lessons of earlier conflicts regionally. With institutions in place, and the analytical capacity and institutional memory they provide, each successive external shock raises the expectation on the part of vulnerable states that similar shocks will occur in the future. Defensive arrangements set in place after previous episodes, moreover, alter the set of choices available to small states when responding to subsequent episodes, creating path dependency. Within a semi-institutionalized region, states have a better platform on which to bolster cooperation after each international monetary crisis, as opposed to allowing it to decay between disturbances. Over successive crises, this can produce an upward ratcheting of regional integration.

Aspirations for political union, by contrast, were not decisive in producing monetary union in Europe. This link is widely asserted in public commentary and some parts of the literature on the European economic integration. EMU, in particular, is frequently cited as the product of widely shared political ambition for something akin to a United States of Europe. (See, for example, Eichengreen 1992) Because this argument carries negative implications for the possibility of integration in other regions, it deserves brief attention here. While commitment to political integration played a role, however, it has been substantially over-rated by some analysts.

Over the course of postwar history, first of all, economic projects for European integration have consistently received greater support than projects for political and security cooperation. Proposals for European Defense Community and European Political Community failed in the 1950s, for example, while the European Economic Community succeeded. (See, for example, Dinan 2004) To choose a contemporary example, the constitutional treaty would have gone some distance toward political integration, but it failed to secure support in critical referenda in France and the Netherlands. The

Lisbon treaty preserves many of its institutional provisions but falls decidedly short of constituting a political union. (Reh 2009).

Second, while it is true that war in Western Europe has become "unthinkable," it has been "unthinkable" for quite some time, at least the 1960s and 1970s if not before. European integration has continued far beyond the point where interstate violence was a conceivable threat. Finally, ambitions for political union do not easily explain the successive enlargements of the membership. Britain, Ireland and Denmark did not join the European Community because they wanted to participate in an ever closer political union. Many of the nineteen countries that have been inducted into the European Union in successive enlargements since then are similarly reticent. Indeed, the greater number and diversity of member states spawned by enlargements have created substantial barriers to political deepening. For these reasons among others, many political scientists conclude that the political-unity motive is a contributing but distinctly secondary motivation for European integration.[11]

Latin American Debt Crisis of the 1980s

At the outset of the Latin American crisis, in August 1982, an analyst might have been forgiven for anticipating a shock of that magnitude to provoke a substantial regional response. Latin America had many of the qualities that might have been expected to favor regionalism. Relative to other regions, including Europe, it had cultural and linguistic homogeneity. Its members largely shared the state-led development strategy of import-substitution industrialization. The Economic Commission for Latin America and the Caribbean (ECLAC), based in Santiago, Chile, had established itself as an informal regional secretariat. Structural economics, developed by Raúl Prebisch as ECLAC's director in the late 1940s and early 1950s, and then dependency theory was widely shared as an economic ideology, one that fostered regional integration as an alternative to market-friendly multilateral trade liberalization. The debt crisis struck nearly all of the members of the region—their interests converged as debtors—and most were similarly antagonized by the policies of the United States and the International Monetary Fund. Yet, the region's response was less integrative, not more, than the responses of Europe and East Asia to their crises.

A broad range of regional, subregional and cross-regional institutions underpinned Latin America's tradition of regionalism prior to the crisis. At the broadest level, the Organization of American States (OAS) and the Inter-American Development Bank (IDB) were both headquartered in Washington, D.C. At the subregional level, the Central American Common Market, Andean Community and Caribbean Community, among others, pre-dated the debt crisis.[12] Each subregional group created a development bank to supplement the work of the IDB and World Bank. These supplemented clearing and settlement systems that had been created to facilitate intraregional trade. For liquidity and balance of payments support, the least developed area of regional financial cooperation, the Central American Monetary Stabilization Fund and the Andean Reserve Fund had been established.

As Titelman (2006) reports, the crisis undermined most of these regional institutions, hitting clearing and settlement systems hardest and the subregional development banks as well. The Andean Reserve Fund (ARF) lent substantially more to the Andean countries during 1983–89 than the IMF lent under exceptional financing arrangements. The ARF, which became the Latin American Reserve Fund (LARF) with the accession of Costa Rica in 1989, thus later inspired proposals for its expansion. (Agosin 2001 and Ocampo 2002) While its financing might have been significant among its particular members, the ARF was a small player in the larger debt crisis and in the event did not leverage the crisis into greater capital commitments or institutional strengthening. The debt crisis also weakened most of the subregional trade agreements, with the exception of the creation of an agreement between Brazil and Argentina that laid the basis for Mercosur's establishment in 1991.[13]

A small literature inspired by the prospect of a "debtors cartel" was an exception to the general absence of political economy studies of the regional response to the debt crisis. The logic behind a debtors' cartel was clear: the crisis was not simply a matter of illiquidity, some degree of debt reduction was also necessary; individually, countries would not opt for or demand debt reduction as this would place them at a disadvantage in capital markets; but together debtors could have greater bargaining leverage *vis à vis* creditors and would be less likely to be blacklisted from future borrowing. In the event, most debtors did not make true transfers of resources back to creditors; with the exception of Mexico, Venezuela and Ecuador, debtors made repayments from loan rollovers. (Lindert 1989 in Eichengreen and Lindert 1989) But each debtor chose to negotiate individually with creditors rather than collectively; debt reduction was effectively accomplished in an ad hoc, uncoordinated, non-transparent fashion across the region.

The failure of the debtors' cartel was due to several factors. First, despite being similarly affected by the crisis, the economic situations of the debtors differed enough to lead some to conclude that they could get better terms by negotiating directly rather than through a cartel. Second, the international banks were implacably hostile to any arrangement that accepted transparent, ex ante debt reduction. Third, low rates of domestic savings and low foreign exchange reserve holdings rendered Latin American debtors crucially dependent on capital inflows and thus on appeasing the banks. Fourth, U.S. policymakers, concerned most for the stability of the banking system, sided firmly with the banks—at least until the threat to systemic stability had passed. (On the failure of the debtors' cartel, see Hojman 1987, Kugler 1987 and Lissakers 1991: 198–204. On U.S. policy, see Cohen 1992)

The debtors' cartel concept was a narrow regional proposal, one with clear zero-sum distributional consequences. What explains the failure of other regional initiatives, ones that would not have so obviously harmed the interests of powerful private actors, to emerge? There are several plausible answers. First, regional and subregional institutions, which antedated the crisis, did not have the staff, financial resources or legal mandate that would have enabled them to leverage the crisis into greater delegation from member states. Second, regional trade agreements were not developed to the point where their disruption could inflict major economic pain in member countries. Regional exports relative to total exports dropped from above 22 percent in 1980 to less than 12 percent in 1985—the largest five-year decline in any of the major regions of the postwar period. But these numbers represented only 3.6 and 1.7 percent of regional GDP respectively, apparently below the threshold for provoking a regional response. Third, more influential in this region than any other, the United States was not particularly inclined toward Latin American regionalism. "U.S. governments have felt deep ambivalence about supporting a more fully institutionalized regionalism that other states might use as a shield against the United States," Katzenstein (2005, 226–7) writes. "The inter-American system was never based on a congruence of interests that might have supported the growth of regional political institutions."

NAFTA and the Mexican Peso Crisis of 1994–1995

The North American Free Trade Agreement (NAFTA) and the peso crisis of 1994–95 were intimately connected. In anticipation of the entering into force of the agreement, multinational corporations and institutional fund managers invested more into Mexico than any other emerging market country in the early 1990s. But NAFTA did not provide for the policy adjustments that would have been necessary to prevent the crisis nor the financial facilities necessary to deal with it once it occurred. The United States responded instead with a large bilateral ad hoc package through the Exchange Stabilization Fund in concert with financing from the International Monetary Fund (IMF) in early 1995.[14] This case is an instance in which a crisis certainly failed to strengthen regional institutions and, if anything, probably weakened the prospects for creating robust ones.

NAFTA is in essence a free trade agreement coupled with some liberalizing investment provisions. It is not a customs union or single market and contains little in the way of regulatory cooperation. It has no provision for currency stabilization, monetary cooperation, fiscal coordination, or development assistance. The Federal Reserve negotiated a currency swap agreement with the Bank of Mexico in conjunction with the Bank of Canada as an adjunct to NAFTA that was quickly overwhelmed during the 1994–95 crisis. NAFTA contained side agreements on labor and environment, of course, as well as established processes for settling dispute in various issue areas. The agreement also created the North American Development Bank, a NAFTA Commission and a NAFTA Secretariat. But these institutions exist in name only; they are underfunded and nearly invisible in policymaking surrounding trade and investment in North America.[15] Instead, as Hufbauer and Schott (2005) observe, NAFTA and the European Union are "polar opposites" in institutional terms.

NAFTA therefore lacked the surveillance capacity at the regional level to anticipate and head off the financial crisis. There was growing consternation with the U.S. Treasury department over the overvaluation of the Mexican peso and efforts to persuade the Mexican finance ministry to address it. But NAFTA placed Mexico under no obligation in this respect and provided no institutional "hook" for the US administration *vis à vis* the Mexican government. In political terms, this lacuna was important. NAFTA presented the most serious and long-fought debate in the United States over trade policy since the Second World War. Though currency matters were missing from the debate, the bilateral exchange rate bore directly on the issues that were discussed: trade, outsourcing and employment. The depreciation of the peso to half its former value within fifteen months of the agreement's coming into force fundamentally changed the terms of competition between the two countries. As a partial consequence, to this day NAFTA remains controversial in U.S. politics, especially within the Democratic Party, and exercises a restraining effect on trade liberalization generally and, for present purposes, regional institution building.[16]

Asian Financial Crisis of 1997–98 and the Chiang Mai Initiative

If the Mexican peso crisis was the "first crisis of the twenty-first century," as Michel Camdessus declared, the Asian financial crisis of 1997–98 was the second. Beginning with Thailand in July 1997, the crisis quickly spread to most of the rest of Southeast Asia and South Korea, before infecting Russia and Brazil, among other places, and eventually the United States through the collapse of LTCM. Stabilizing financial markets involved commitments from the international community summing to hundreds of billions of dollars. Chastened by the Mexican crisis and wary of indulging moral hazard, however, the United States and IMF were relatively slow to respond.

Shortly after the onset of the Thai financial crisis in July 1997, the Japanese Ministry of Finance famously proposed the creation of an Asian Monetary Fund. The Chinese government failed to endorse it, however, and the United States government opposed it outright, offering to create instead a forum in which East Asian concerns could be addressed, the Manila Framework Agreement. Japan provided significant bilateral financing to its Asian neighbors instead through the New Miyazawa Initiative. The greater share of balance of payments support for Southeast Asian countries and South Korea during the crisis nonetheless came from the IMF, which imposed policy conditions that cut deeply into the political economy of borrowing countries. Such conditionality became the center of controversy within the domestic politics and regional discourse in East Asia. The literature on the political economy of Asian regionalism is virtually united in the assessment that these countries were profoundly alienated from the IMF and that this alienation was principally responsible for their creating the Chiang Mai Initiative.[17]

The CMI was launched at a meeting of ASEAN+3 finance ministers in Thailand in May 2000. They announced a broad set of objectives for financial cooperation, involving policy dialogue, monitoring of capital flows, and reform of international financial institutions. The finance ministers would also later add bond-market initiatives and regional bond funds to their agenda for regional cooperation. But at Chiang Mai, their core objective was to establish a network of bilateral swap arrangements (BSAs) between Northeast and Southeast Asian members. As these BSAs were negotiated and concluded over the subsequent years, their number grew to sixteen.

There were several noteworthy things about these arrangements. First, in principle, Thailand, Malaysia, Indonesia, the Philippines and Indonesia could borrow several multiples of their IMF quotas through their CMI BSAs.

Second, however, their access was linked to their negotiating a program with the IMF with its attendant policy conditionality—except for the first twenty percent of their allotment. Conceived as such, the CMI was largely a "second" or "parallel line of defense" to IMF financing. The "IMF link," as this provision is called, helped to secure the accession of the Chinese government to the CMI and mollify the U.S. government. Third, ASEAN+3 finance ministries and central banks also launched a regional surveillance mechanism called the Economic Review and Policy Dialogue (EPRD). Many officials within the region hoped to develop the EPRD to the point where it could define regional conditionality in a crisis and thereby permit a diminution, and perhaps eventually elimination, of the IMF link.[18] Finally, partly owing to the IMF link, none of the BSAs were activated, even during the 2007–2009 crisis.

The ASEAN+3 process has been almost entirely intergovernmental. The leaders of the ASEAN states invited their counterparts from China, Japan and South Korea to join them for the first time in the heat of the crisis, November 1997, and have been meeting at least annually since then. The CMI was developed by the ASEAN+3 finance ministries, with their central banks, in meetings of deputy ministers and working groups. The ERPD is conducted through the ASEAN+3 finance deputies meeting, which central bank deputies attend, twice each a year. The Asian Development Bank and the ASEAN Secretariat provide input to the ERPD discussions, as well as the IMF staff. But much of the surveillance discussion and all of the negotiations surrounding the establishment of the CMI and the individual BSAs took place without the benefit of a collectively appointed secretariat.

Member states of the region are also engaged in negotiating multiple, cross-cutting bilateral, subregional and cross-regional preferential trade agreements.[19] While the pattern of trade liberalization is broadly consistent with regional financial cooperation, there is little or no linkage between the regional initiatives in the trade and financial areas. Measures of the degree of integration of markets in East Asia are sensitive to the choice of group. For the seventeen economies,[20] intra-regional trade has exceeded half of their total trade since 2000. But for ASEAN+3 alone, this figure is only about 34 percent, roughly comparable to the current figure for the six original members of the European Community.

Tension between Japan and China over the pace, direction, and institutionalization of these arrangements has pervaded regional negotiations. Prospective shift in relative influence within the region toward China as its economic growth outpaces that of Japan by a wide margin, counsels officials in Beijing to bide their time until they might bargain from a more favorable position.

Meanwhile, regional initiatives have benefited from the tendency of the two countries to compete for the favor of ASEAN with cooperative measures. (Grimes 2009) But more robust institutional arrangements will require transcending or suspending the rivalry. Agreement between the two is a necessary but not sufficient condition for deepening institutionalization.

The posture of the United States has evolved substantially over the twelve years since the Asian financial crisis. After scuttling the AMF proposal in 1997, the U.S. Treasury accepted the creation of the CMI in 2000 but reserved judgment on its merits.[21] Comforted by the IMF link, however, the administration of George W. Bush did not oppose the further development of the CMI, the other regional financial initiatives, or the surveillance mechanism.[22] Equally importantly, the U.S. Treasury supported reforms in the IMF that were advocated by many Asian governments, including redistribution of quotas and voting shares, the introduction of quick-disbursing, low-conditionality financial facilities, and reconsideration of policy conditionality on standby loans. Substantial progress was made on this agenda when the IMF was enlarged and refitted to combat the 2007–2009 crisis.

2007–2009 Crisis and CMIM

The crisis that began in the subprime mortgage market in the United States in 2007 and became global over the course of 2008 had two substantial consequences for East Asian financial regionalism. In the first instance, it revealed some of the limitations of the CMI. South Korea, which was most affected among ASEAN+3, declined to activate the CMI, the IMF link having made this option politically unattractive for the government. Instead, the U.S. Federal Reserve extended currency swap arrangements to fourteen countries in autumn 2008, including South Korea and Singapore, in the amount of $30 billion, and for Japan, in unlimited amounts.[23] Korea drew large amounts from this facility to provide dollar liquidity to banks in a successful crisis response. These swap facilities provided an alternative to both regional and multilateral financial cooperation for some, but not all, of the ASEAN+3 members.

Over the following year, by contrast, the crisis also prodded ASEAN+3 to re-energize negotiations to transform the CMI, a network of bilateral swaps, into a commonly activated arrangement. The credibility of ASEAN+3 hinged substantially on demonstrating progress toward their previously declared objective of CMI "multilateralisation," or CMIM. The most difficult matter, in addition to several important technical ones, was the relative shares of the three Northeast Asian states in the new arrangement, those of Japan and China in particular.

Meeting in Bali, Indonesia, on the margin of the Asian Development Bank meetings in May 2009, the ASEAN+3 finance ministers announced agreement on the main features of the CMIM. Members earmarked a total of $120 billion in their reserves and placed them at the disposal of the arrangement; the contribution of Japan would be equal to that of China and Hong Kong together, 32 percent each; borrowing limits were defined as multiples of quota; membership and lending terms would be decided by consensus while lending would be decided by two-thirds majority.[24] The CMIM retained the link to the IMF, but the linked proportion was subject to review. Reducing it would continue to hinge on development of a robust regional surveillance mechanism. The CMIM became operational in March 2010 and ASEAN+3 agreed to create a relatively modest-sized surveillance secretariat.[25] That secretariat, the ASEAN+3 Macroeconomic Research Office (AMRO), was established in Singapore in May 2011. AMRO's mandate is to collect and analyse information on the economic and financial conditions and policies of members and present its findings to the deputies' and ministers' meetings, including with respect to any activation of CMIM.[26] Meeting in Manila in May 2012, ASEAN+3 finance ministers and central bank governors agreed to double the size of the CMIM to $240 billion, increase the portion that is delinked from the IMF to 30 percent, and make financing available on a precautionary basis.[27]

The progression from the CMI, a network of bilateral swap arrangements, to the CMIM, a common institution, is a potentially profound movement. As a common regional facility, the ASEAN+3 partners in the CMIM commit themselves to a joint decisionmaking process. Moreover, the majority rule for lending decisions provides in theory for individual members, even Japan or China, to be overruled. This shift, in principle, is akin to the transition from a free trade area to a customs union—which requires a common decision on external tariffs and a governing body or process for making decisions. If ASEAN+3 were to implement common decisionmaking fully, this would represent a substantial change in regional politics. The establishment of a secretariat for surveillance and backstopping the CMIM, AMRO, crosses a similarly novel threshold for the region.

East Asian governments are hedging their move to the CMIM, however, in three ways. ASEAN+3 members have also embraced self-insurance in the form of unilateral reserve accumulation, expanded some of the bilateral swap arrangements, within and outside the region, and continued to support the IMF. Thus, East Asian governments have not placed all of their crisis-defense "eggs" in one regional "basket"; they have diversified.

Taken together, the 1997–98 and 2007–09 episodes nonetheless highlight the importance of crises as generators of regional institutions. Skeptics might argue about the significance of the CMIM, given that it has not been used, but few would argue that the 1997–98 crisis was not a direct motivation for its creation. Moreover, the impetus toward regional surveillance and a commonly administered arrangement flagged during the liquidity boom years, when the threat of crises was small, and then accelerated when crisis loomed again in 2008. Crises were more than mere accelerators of some hypothetical underlying trend toward regionalism; it is hard to imagine a plausible counterfactual scenario without them that could have brought East Asia to implement the CMIM.

Comparison and Conclusion

The review of these cases generates several observations and insights about the effect of crises on institution building within regions. We would not logically expect all crises to generate a regional response. When a *crisis originates* within the region and when the *extra-regional response* is supportive, then regional institution building is not likely. But, when a crisis originates outside the region and the extra-regional response is inadequate or adversarial, regional institution building is a logical response and we can sensibly ask analytical questions about the sources of variation in the regional reaction. In these instances, several background conditions emerge from this comparison as favorable for institution building in the wake of a crisis.

First, the presence of a *secretariat* with a mandate to defend and advance regional integration appears to be important, as it characterizes the most successful case, that of Europe. Intergovernmental cooperation through the Committee of Central Bank Governors and Ecofin was sometimes more important than the activism of the Commission, in that case, and the CMI case suggests that substantial institution building can take place without a secretariat. We can conclude that, while neither strictly necessary nor sufficient, a secretariat facilitates further institution building.

Second, a significant degree of *market integration* appears to be necessary but not sufficient for post-crisis institution building. The two cases of substantial institution building, Europe and East Asia, exhibit moderate to high levels of intra-regional trade; but so does North America, which produced little or no institutionalization beyond NAFTA after the 1994–95 crisis.

Third, functional spillovers among regional arrangements that are related to trade, money and finance appear to be necessary conditions for an institution-building response. Crises must threaten the interests vested in political agreements on related economic matters in order to provoke institution-building. But the Mexican peso crisis case suggests that such linkages are not sufficient.

Fourth, the presence of a dominant state appears to have ambivalent effects on regional institution building. Germany had greater influence than France over the construction of the monetary union in Europe, but that influence fell well short of regional hegemony. U.S. dominance of North America contributed to the creation of NAFTA, but probably prevented the development of supranational bodies within it. A regional rivalry, as seen in East Asia, on the other hand, appears to constrain the depth and form of institutions.

Fifth, the multilateral context matters a great deal: when the international monetary system or international financial institutions clash with the preferences of member states, these states will seek to build regional institutions that better serve their aspirations. Because a challenging multilateral environment was present in both the European and East Asian cases, this condition appears to be necessary.[28] Also present in the debt crisis of the 1980s and the Mexican crisis of 1994–95, this condition is clearly not sufficient to produce institution building. Conversely, if the multilateral system is benign or supportive, the construction of regional institutions is not a high priority and possibly redundant.

Sixth, the position of the United States on institution building within a region appears to be a powerful determinant. No regional institution was constructed over the opposition of the United States. European monetary integration benefited from a benign stance in Washington,[29] Treasury officials opposed the AMF proposal and East Asian financial cooperation progressed after establishing the IMF link and thereby shifting the U.S. stance toward "neutral." That said, U.S. support for regional institutions is certainly not sufficient; some organizations with U.S. sponsorship have failed.

One might question the importance of the American position for the future of regionalism in Asia in light of long-term projections of the relative decline of the economic size of the United States. It is indeed possible that the posture of the United States will be less influential in the future that it was during the second half of the twentieth century. However, U.S. influence is not likely to vanish altogether and the degree of the structural shift toward Asian influence is uncertain. Given the robustness of this finding historically, advocates of regionalism would be unwise to dismiss its relevance for institution building.

Finally, this chapter has argued that aspirations for political integration or political union were neither necessary nor sufficient for substantial progress on regional institution building in economic areas. Analysis of political motivation should carefully distinguish between (a) ambitions for political union, (b) desire to avoid security conflict and war, and (c) political agreement on economic measures and the institutions necessary to implement them. Regional integration obviously cannot take place in the face of sharp security threats or interstate violence. Ambitions for political integration and a peace community can certainly reinforce regional integration, but they are not necessary. Political agreements on common economic measures and the institutions to monitor them are indeed necessary, but pose considerably lesser hurdles than agreements on political integration. Significant political integration is out of reach in East Asia, and probably in North America, whereas agreement on economic cooperation has been achieved and can be deepened in both regions.

The turmoil within Europe's monetary union that began with Greece during early 2010 presents a new case of the relationship between crisis and institution building. The euro crisis demonstrates that, while a monetary union might insulate member states from currency crises, it does not inoculate them from payments, banking or sovereign debt crises. Whether the member states of the euro area succumb to or surmount this threat to the monetary union remains to be seen. European institutions and national governments were consistently "behind the curve" during the first two years of this episode, creating doubts about whether the monetary union would navigate the crisis successfully. At the same time, nonetheless, the Eurogroup created new financial facilities on a scale virtually no one envisioned prior to the crisis, the euro area member states tightened fiscal rules and procedures with a new treaty, and the European Council advanced reforms that could permanently strengthen the institutional architecture of the euro area and redefine its relationship to the rest of the European Union. This episode also suggests however that a monetary union requires a more robust banking and fiscal union, and the political arrangements to support it, than originally envisaged in the Maastricht treaty.

With respect to Asia in particular, our review of crises over the last four decades shows that they can provide a strong boost for regional institution building. But, as in other regions, the magnitude of this boosting effect depends on the source of the shock, response of multilateral institutions, and prior circumstances. When the source of crises is external to Asia and the response of multilateral institutions conflicts with the preferences of ASEAN+3 governments, regionalism is likely to be reinforced. Conversely, when the crisis is indigenous to the region and the response of the international financial institutions is aligned with Asian preferences, regional institution-building is not likely to accelerate.

Regional intergovernmental bodies can be as conducive to further institution building as supranational ones; both can be reinforced by regular summits of heads of governments. A fruitful strategy for advocates of Asian regionalism, therefore, would be to first lay the institutional groundwork for integrative responses (as ASEAN+3 has done with CMIM and AMRO) and then exploit it opportunistically when crises open new possibilities for cooperation. By designing such institutions well, Asia could ratchet regional cooperation upward over successive iterations of crises—following the European pattern even while declining to adopt the European institutional form.

Kahler emphasizes the segmentation of Asian institutions by issue area in the introduction to this volume; indeed, this applies to trade, development and finance as well as to economic and security issues more broadly. Because interlocking agreements, secured with cross-issue bargains, can be a strong inducement for institution building—our finding here—there are likely to be substantial unexploited gains from cross-issue bargains in Asia, which regionalists will want to foster.

Finally, the importance of the multilateral environment and outside states, such as the United States, suggests that Asia should advance cooperation between its regional institutions and those at the global level. Although accommodation of regional preferences by multilateral institutions might weaken the case for regional institutions, cooperation with global institutions will help to soften the objection of outsiders and bridge differences among states within the region over the path along which regional institutions evolve, as witnessed in the creation of the CMIM. Such cooperation can also help assuage possible concerns on the part of the candidates that are next in line in the membership convoy.

Notes

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1. See, for example, Krasner (1983, 1); Goldstein, Kahler, Keohane, and Slaughter (2000, 387); Koremenos, Lipson and Snidal (2001, 762); Milner (1998, 761); and Eichengreen (1998, 996).

2. Quoting Gourevitch (1983, 240), "The moments of greatest freedom are crisis points."

3. For reviews, see, Wallace, Wallace and Pollack 2007; Caporaso 2007; Eichengreen 2006; Henning 2005; and a special issue of *the Journal of European Public Policy* (April 2005).

4. Henning 1998, 2002 and 2008.

5. Defined as the inter-penetration of national markets, as opposed to common regional rules and frameworks, and thus measurable by trade relative to GDP, capital flows relative to domestic market capitalization, and price convergence across borders.

6. Defined as consequences in one sphere of regional cooperation that are generated by disturbances in another sector. Drastic shifts in the exchange rates among European currencies severely complicated the Common Agricultural Policy, for example, to which European officials responded by stabilizing currencies. Distinct from economic transmission effects, this process evokes "spillover" from the neofunctionalist literature.

7. For examples of these approaches, see, Eichengreen 1996, esp. 3–12; Padoa-Schioppa 2004; Giavazzi and Pagano 1988; Gros and Thygesen 1992, 100–60; Willett and Andrews 1997; Frieden 2002; Moravcsik 1998; Cohen 1993; Pauly 1992; McNamara 1998; Sandholtz 1993; and Eichengreen and Frieden 1994.

8. Elsewhere (Henning 2006), I have referred to the use of the exchange rate in this way as the "dollar weapon" and discussed its analytical underpinnings.

9. Treatments of these episodes can be found in Putnam and Henning 1989, Destler and Henning 1989, and Henning 1994, among a number of other places.

10. Henning 1998, esp. 547.

11. See, for example, Moravcsik 1998. O'Rourke's chapter for this volume gives similarly little credence to this motive.

12. Jorge Dominguez reviews these, emphasizing the trade and political features, in his chapter for this volume.

13. For an assessment of the impact at the time of the crisis, see Gauhar 1985.

14. Lustig 1998, Henning 1999, and Pastor 2001.

15. Dominguez's chapter in this volume is somewhat more generous.

16. On prospects for currency union, see, Helleiner 2006.

17. The development of the CMI and associated policy issues are debated in Henning (2002, 2009), Eichengreen (2002b), Bergsten and Park (2002), de Brouwer (2004), Kuroda and Kawai (2004), Katada (2001, 2004), Rajan and Sirigar (2004), Amyx (2008), Lee (2006), and Grimes (2009), among others.

18. Contributions on ASEAN+3 surveillance include Kawai and Houser (2007) and Institute for International Monetary Affairs (2005).

19. See Ravenhill (2009), Baldwin (2004 and 2008) and Solis, Stallings, and Katada (2009).

20. Australia, New Zealand, Hong Kong,and Taipei, China in addition to ASEAN+3.

21. Arran Scott and James T. Areddy, "U.S., IMF Cautiously Welcome Asia Currency Swap Plan," Dow Jones International News, May 8, 2000.

22. US Treasury Department, "Remarks by Under Secretary for International Affairs Timothy D. Adams at the World Economic Forum- East Asia Panel on Asia's Financial Integration: A Miracle in the Making?," Tokyo, June 15, 2006.

23. U.S. Federal Reserve Board press release, Washington, D.C., October 29, 2008, available at http://www.federalreserve.gov/newsevents/press/monetary/20081029b.htm.

24. ASEAN+3 finance ministers' statement, Bali, Indonesia, May 3, 2009, paragraphs 7-9 and Annex; Capannelli (2009).

25. ASEAN+3 finance ministers statement, Tashkent, Uzbekistan, May 1, 2010. The surveillance unit is named the ASEAN+3 Macroeconomic Research Office (AMRO).

26. ASEAN+3 Finance Ministers, Joint Media Statement of the 14th Meeting, Nha Trang, Vietnam, April 8, 2010.

27. ASEAN+3 Finance Ministers and Central Bank Governors, Joint Statement of the 15th Meeting, Manila, the Philippines, May 3, 2012.

28. Henning 1998 and 2008.

29. Similarly, O'Rourke's chapter for this volume stresses the importance of the U.S. support for European supranationalism in the 1950s.