Essay: Based on readings and class lectures, answer ONLY 1 of the following questions:

1. How did East Asian nations respond at the regional level to the Asian Financial Crisis of 1997-98, beginning with the initial responses during the crisis, and subsequent efforts after the crisis was over? Evaluate the effectiveness of these regional cooperative responses and draw lessons for avoiding a future crisis.

Answer: The most important initial regional response to the AFC was Japan’s Fall 1997 proposal to create an Asian Monetary Fund (AMF), a regional financial organization that would make emergency loans to distressed Asian nations without the International Monetary Fund’s (IMF) reputedly “harsh” conditionality. In this sense, the AMF would replicate, if not replace the IMF’s role in East Asia. The US opposed this AMF proposal for a combination of ideological and political reasons. The US was ideologically committed to IMF conditionality, arguing that states that needed an IMF bailout must first agree to a harsh austerity regime of governmental budget cuts and higher interest rates, while also reducing trade and investment barriers. The US also feared that a Japan dominated regional AMF would, by diminishing IMF influence, would also diminish US influence in the region. The US recruited China as an ally by playing on its fears that Japan would gain regional dominance as a result of the AMF proposal, and lead to a return of the “chaos of the 1930s.” The US and China were successful in shooting down the AMF proposal, even though it had initially attracted strong support from the ASEAN states. Nonetheless, the AMF proposal was resurrected in function, if not form, in 1998/99. First, Japan created the so-called Miyazawa fund in 1998. Although smaller than the AMF fund it had earlier proposed, the Miyazawa funds were also designed to provide emergency funding to East Asian states suffering from the AFC. By 1998 and 1999, initial regional opponents of the AMF proposal, most notably China and South Korea, had come around to support the idea. Although the AMF was not resurrected, East Asian states agreed upon the so-called Chiang Mai Initiative (CMI), which aimed at monetary cooperation, a regional network of bilateral currency swap agreements, to fight off renewed currency
speculation, create an East Asian bond market, and study movement toward a common East Asian currency in the longer term future. The CMI was initially criticized for not being large enough or flexible enough to prevent a renewed financial crisis, especially since nearly 90% of the funds pledged to the CMI were initially tied to IMF approval, and hence IMF conditionality. Nonetheless, over time the proportion of CMI funds tied to IMF approval has declined.