7 WHAT THE U.S. AND ASIA SHOULD DO: ESTABLISH A GLOBAL FINANCIAL CRISIS SECRETARIAT AND AN ASIAN FINANCIAL FACILITY

Wing Thye Woo

What's at Stake

It would be a big mistake for the G-20 to squander the November 15 meeting discussing the French-British proposal for a New Bretton Woods. As the still raging global financial crisis was not primarily caused by the flaws in the present international monetary system, Asia and the U.S. should insist that the discussion be narrowly focused on the global coordination of fiscal stimulus and monetary loosening, global avoidance of beggar-thy-neighbor policies of export promotion and import restrictions, global harmonization of regulations governing financial institutions and accounting practices, and the feasibility of the U.S. Federal Reserve broadening its temporary network of bilateral swap lines to other well-managed emerging economies.

What Should be Done

An *ad hoc* Global Financial Crisis Secretariat (GFCS) should be established to undertake global coordination on these matters, and be temporarily housed as an autonomous unit (in the manner of the World Bank) within the office of the UN Secretary-General. Simultaneity in expansionary macroeconomic policies is GFCS's most important objective because it prevents deterioration in the trade balances from rendering each country's expansionary policies unsustainable.

If another G-20 summit is set for the future, Asia and US should support the establishment of a GFCS working group on the reform of the IMF: how much to increase its resources to allow it to fight global financial fires, how wide to increase its jurisdiction to authorize it to improve regulation of financial markets, and how radically to restructure its ownership to give it the legitimacy to impose its will on prostrate economies. While an improved IMF is highly desirable, both the US and Asia should recognize that the better first line of Asian defense against financial contagion would be a greatly enhanced swap facility, the Asian Financial Facility (AFF), because Asia collectively now has enough reserves to fend off unwarranted speculative attacks on a subset of its members. It must be emphasized that the core mission of the AFF is to combat financial contagion and not to finance balance of payments adjustment caused by economic mismanagement.

An AFF is necessary because it is simply impossible (certainly, inefficient) to increase the size of the IMF enough to enable it to have in-depth expertise on most of the countries to be able to respond optimally in a timely manner to each national crisis. Furthermore, the IMF policies are decided by Executive Directors who usually take their orders from their national ministries of finance and central banks, and it would be credulous to think that a significant proportion of these national economic agencies would have up-to-date understanding of most of the emerging economies. Even if the improved technical competence of the IMF is not doomed to disappoint the emerging economies, the emerging economies would be disappointed by the long time required for an improved IMF to appear. The negotiations on meaningful IMF reforms would inevitably be cantankerous and hence protracted.

Right now, East Asia has a thin network of swap lines to defend their currencies. It would be desirable to hasten the evolution of the existing swap facility into the AFF by two actions. First, the existing swap facility specifies that a cumulative drawing that exceeds 20 percent of a country's quota would require the country to accept IMF supervision. This "flight-to-IMF" clause should be removed because painful memories of 1997-98 make it politically suicidal for any East Asian leader to do so. Second, because the primary purpose of the AFF is to reduce the cost of bad luck and not of bad economic policies, the removal of the "flight-to-IMF" clause requires that the swap facility establish a surveillance mechanism to pre-qualify its members for emergency loans. Without this surveillance mechanism, the Asian Financial Facility would not attain a meaningful size because no member would be willing to risk committing a large part of its reserves to the facility.

Why should the G-20 support a GFCS? The IMF simply lacks legitimacy and credibility in the eyes of East Asia. The Sarkozy-Brown proposal for a New Bretton Woods is part of the continuing effort by Old Europe to maintain its disproportionate representation in global governance bodies like the UN Security Council, the IMF and the World Bank. The proposal to make the unreformed IMF the super financial policeman of the world is unwise because the concentration of so much power in its hands would magnify the impact of any faulty operational procedure and allow the mistake to be unchecked for a longer time. If need be, the assignment of global financial regulation to an expanded BIS would be a better alternative. The IMF should forgo expansion of its jurisdiction and become instead a more specialized agency that undertakes macroeconomic surveillance for the world, and balance of payments assistance for the emerging economies. The UN is the global organization with the most legitimacy, and its temporary custody of the GFCS would, one, be a good signal by the G-20 of their genuine desire to make multilateralism work; and, two, be a collective statement that it is time for the national allocation of global responsibilities to be reconfigured.

Why should the US support an AFF? The US and other countries would be members of the AFF just as they are now influential members of the Asian Development Bank. In dealing with Asia, the US should rely less on the hard power of a formal dominant role in global leadership, and more on the soft power of leading by example, like helping Asia do what's best for Asia (which is an excellent start to the US re-engagement with Asia). The AFF would expand over time to be an APEC-level institution; and be a good partner to the IMF because "two heads are better than one" in analyzing unexpected quickly-evolving crises and in preventing their contagion.

The Bottom Line

The bottom line for the November 15 meeting is that the focus should be on fighting global recession and not on reforming the international financial architecture; and the bottom line for beyond November 15 is that the better way to improve the supply of global public goods is not to simply increase the size of the existing providers but to increase the number of providers while seeking to improve the performance of existing ones. The GFSC is the change we want to allow simultaneous implementation of macroeconomic stimulus, and harmonized regulation of financial markets. The US support for AFF is the much-needed change toward an inclusive US approach that is diversified in modality to handle each specific multilateral issue. If the G-20 can act decisively on November 15 on these well-defined economic tasks, the world can then have more faith that enlightened self interests will also accomplish the much more arduous task of containing environmental contagion from global climate change (the change we do not want).

Wing Thye Woo is a Senior Fellow at the Brookings Institution, and the New Century Chair in International Trade and Economics.