

ISSUES



PECC INTERNATIONAL SECRETARIAT

4 Nassim Road Singapore 258372
Tel: 65-6737 9823 Fax: 65-6737 9824
Email: peccsec@pacific.net.sg
Home page: <http://www.pecc.net>

PACIFIC ECONOMIC COOPERATION COUNCIL



Financial and Monetary Cooperation in East Asia: a Road Map

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About this Issue

This **ISSUES@PECC** summarizes the main findings from the discussion on *financial and monetary cooperation in East Asia at a crossroads* at the 2nd Annual Conference of the PECC Finance Forum held in Hua Hin, Thailand, on July 8-9, 2003.

The PECC Finance Forum serves as an open forum for a tri-partite dialogue among the academia, government, and business sector, on the financial policy issues facing the Asia-Pacific region. The purpose of the dialogue is to assess the international environment for financial stability and development in the region, to assess progress in the promotion of financial reforms, integration and cooperation in the region, and to develop the desired vision of regional financial and monetary cooperation. For the purpose of these assessments, the Finance Forum undertakes survey-based task force studies on specific issues as well as convenes an annual conference of experts drawn from the member economies and the international financial institutions. For more information, visit www.pecc.net/finance.

The authors of this summary report are:

Prof Wendy Dobson

University of Toronto, Toronto

Prof Gordon de Brouwer

Australian National University, Canberra

Dr Soogil Young

Coordinator, PECC Finance Forum

Editorial Committee:

Dr. Soogil Young

Coordinator, Finance Forum

Ms. Eunsuk Lee

Assistant Coordinator, Finance Forum

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Background

The Asian financial crisis of 1997-98 has triggered a proliferation of efforts among the economies in the Asia-Pacific region, especially, among those in East Asia, to promote regional cooperation for financial and monetary stability. Thus, such cooperation has become a new main focus at a number of existing regional economic forums such as SEANZA, ASEAN, SEACAN, EMEAP. A few regional forums such as the Manila Framework Group and the ASEAN Plus Three's Finance Ministers Meeting have been newly created for essentially the same purpose. The latter one, in particular, launched the Chiang Mai Initiative (CMI) in May 2000 whose immediate objective was to create a regional financial arrangement for mutual liquidity support among the member countries. The ASEAN Plus Three's Finance Ministers Meeting has been engaged in the effort to deepen and develop CMI since then.

These developments seem to indicate the possibility of the emergence of regional systems of policy cooperation for financial and monetary stability in East Asia, including an Asian Monetary Fund in the medium-term and an Asian common currency in the long-term.

Obstacles to the realization of such possibility are well-known as well, creating divergence of views as to the goal and the approach to be taken by the East Asian governments in the pursuit of regional cooperation for financial and monetary stability.

Such divergence of views was evident in the result of the survey that the PECC Finance Forum undertook in 2002 on the prospects for closer regional financial and monetary cooperation in East Asia.¹ The survey, however, also confirmed that there was a unanimous desire among the East Asian governments for deepening financial and monetary cooperation while governments in the other parts of the Asia-Pacific region were, in principle, supportive of this desire.

The discussions on financial and monetary cooperation at the 2nd Annual Conference of the PECC held in July, 2003, were focused on the 'road map' to guide the future effort to deepen financial and monetary cooperation in East Asia. These discussions were guided by, and based on, a paper prepared by Professors Gordon de Brouwer and Takatoshi Ito in which a three-part road map was presented. What follows is the summary of those discussions.

¹ See ISSUES@PECC, "Prospects and Challenges for Regional Financial and Monetary Cooperation among PECC Economies: Government Perspectives on Regional Financial Cooperation", 2002.



A Road Map for Deeper Regional Cooperation

The three-part road map consists of:

- strengthening domestic institutions and markets;
- developing regional arrangements and markets; and,
- creating appropriate institutional structures.

1. Strengthen domestic institutions and markets

The first element, and a basic building block for the other two, is to strengthen domestic financial institutions and markets. Without strong and effective financial institutions and markets, economic growth will be lower and more variable. Weak financial systems and markets make the region vulnerable to future economic shocks. Regional cooperation efforts cannot fully succeed unless they are built on strong domestic financial systems.

There was consensus on the need to address the detail and substance of improving financial institutions and markets, including strong legal systems, clean bureaucratic, judicial and government processes, open information, sound governance and supervisory systems.

2. Develop regional arrangements and markets

The second element in the road map focused on the wide agenda for regional financial and monetary cooperation. This agenda has at least four parts:

Policy Dialogue and Surveillance: These are necessary conditions for prompt financial cooperation and assistance extended by regional neighbours during a financial crisis in one country. There should be open and frank sharing of information as well as discussion of policy issues and options among policy-makers, possibly including with academics.

Regional Financial and Capital Markets: Developing bond markets at the regional level as well as the national level enhances regional financial stability by helping avoid the double mismatches, reducing over-reliance on the bank financing, and allowing to tap regional savings.

Regional Financial Arrangements: A regional system of liquidity support for the prevention and management of financial crises, consisting of instruments, techniques and institutions should be developed.

Monetary Policy and Exchange-rate Systems: There should be cooperation to ensure the monetary policy and exchange-rate regimes which are consistent between economies.

This agenda contains a progressive pattern of sequencing. At the early stages, deepening policy dialogue and surveillance is an immediate priority.

3. Create appropriate institutional structures

The third element in the road map is the importance of creating institutional structures to advance cooperation at all levels of interaction and community in the region. Institutions are important because they provide a forum for interaction and a resilient structure for cooperation when destabilising events inevitably occur.

Structures need to be developed at the official, i.e., first-track, level, including a secretariat for ASEAN+3 and evolution of ASEAN+3 into an East Asian Community. The region also needs second-track processes, bringing together policy-oriented researchers in think tanks and universities with market participants from the private sector.

There are three points about the strengthening of these different track processes:

- Track one and two processes can be brought together in “1.5 track” processes. The resulting cooperation provides depth to the regional community;

- The East Asian region consists of more players than those in ASEAN+3. It is to the region’s own long-term advantage to encompass these wider interests in its own processes, including at the track two and 1.5 track processes. For example, it is hard to see how East Asia can comprehensively aim for financial market and institutional development without including Hong Kong and Australia;

- In the process of developing a regional community, the region should not be overly concerned about overlap in dialogue and cooperation. It is better to err on the side of too much talking at both official and non-official levels than too little.

Work Program for the PECC Finance Forum

The discussions at the conference on the road map for regional financial and monetary cooperation brought forward a three-part future work program for the PECC Finance Forum itself:



Monitoring and Assessment of Regional Initiatives

The efforts to create and strengthen regional financial arrangements and markets taking place in the Asia-Pacific region should be monitored and assessed. Constructive criticisms and policy recommendations should be offered to regional governments and institutions as well as APEC.

A Scorecard Exercise on Domestic Reforms

PECC should undertake comparative assessments of the state of reforms in financial institutions and of development in financial markets.

The assessment of financial institutions should include examination of asset quality, the quality of governance,

decision-making and risk management. The assessment of markets should include examination of not just the size and depth of the various financial and capital markets (debt, equity, FX, money and derivatives markets), but also their efficiency in pricing, the impact of microstructural features in markets (including foreign participation), the legal and operating environment, and use of technology.

Stocktaking and Assessment of Capacity-Building Programs

The international financial institutions provide development assistance for the purpose of helping capacity-building in the financial sector in many forms but these have not generally been objectively evaluated in terms of effectiveness and complementarity.

References

The following papers on financial and monetary cooperation in East Asia were presented and discussed at the 2nd Annual Conference of the PECC Finance Forum held in Hua Hin, Thailand, on July 8-9, 2003:

De Brouwer, Gordon and Takatoshi Ito, "Financial, Monetary and Economic Cooperation in East Asia: Where We Are, Where We Want To Be, and How We Get There from Here"

McCauley, Robert N., "Central Bank Cooperation in East Asia"

Rana, Pradumna B., "Monetary and Financial Cooperation in East Asia: The Way Ahead", a power point presentation.

These papers are available on-line at <http://www.pecc.net/finance/forum2003>.