

**PECC Finance Forum Conference**

*Issues and Prospects for Regional Cooperation for Financial Stability and Development*

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**Day One: Scope for Regional Financial Cooperation among PECC Economies**

**Session III: Other PECC Economies' Perspectives**

Country Perspective Paper: Canada

**PECC FMC Survey: Canada**

Wendy Dobson  
University of Toronto

## **A. Introduction**

Canada is a member of APEC, the Manila framework group (MFG), the Canadian Finance Minister chaired the G-20 during its first two years, and Canada hosted the most recent G-8 summit. As a medium-sized open economy next door to the United States, Canada values financial and monetary cooperation, both as a global public good promoting economic stability and to buffer its economic relationship with its large southern neighbor.

Canada's official positions in the G-20 and IMF in the wake of the Asian financial crisis have emphasized the need to change the incentives for participants in international financial markets. Canadian officials believe that private sector participants should be more involved in crisis resolution. Finance officials have advanced and supported schemes for private sector involvement (PSI); the Bank of Canada has worked with the Bank of England to propose that IMF resources for crisis management be restricted so as to reduce moral hazard by shifting more responsibility for crisis resolution to the private sector.

Canadian officials expressed some skepticism about the prospects for financial and monetary cooperation. The view was expressed that cooperation and reliance on peer pressure to improve economic policies and performance doesn't seem to work very well anywhere. The IMF and OECD provide two of the most successful forums. Another general comment was that there is a big risk in appearing to have a cooperative mechanism, but to be unwilling to use it.

A further comment raised questions about the relative importance of trying to reduce real exchange-rate volatility in today's global financial markets. Rather, a more realistic approach might be to strengthen financial systems enough to withstand external shocks including real exchange rate volatility.

The comments in this paper are based on the views of senior officials in the Finance Ministry, Central Bank and Foreign Ministry, and a knowledgeable academic.

## **B. Regional Institutions**

Officials were requested to express their views of the value of the various financial and monetary institutions in the PECC area and to evaluate their effectiveness. Of course, since Canada participates only in the APEC Finance Ministers meetings and the MFG, views of the other regional institutions are impressionistic but perhaps useful.

As an overview comment, some officials commented on the distinction between cooperation and consultation; with regional institutions perceived to be mostly consultative rather than cooperative. One comment, from the Finance Ministry, was that the only institution that fulfills its mandate effectively is EMEAP.

ASEAN+3 is seen as quite focused on promoting cooperation. But it is also in need of an effective peer review mechanism and appears, at least to an informed outsider, to follow the non-interference Asian tradition. This raises the serious question that, if true, this mechanism is unlikely to be able to prevent future financial crises, and indeed could contribute to debtor moral hazard.

EMEAP includes the main players in ASEAN+3 but adds Australia, New Zealand, and North America. It provides the best example of cooperation. It is taken seriously, but of course is limited to central banks.

The Manila framework group also includes a broader range of players, but is not taken seriously. It has no deputies' process and therefore no substantive activities between its meetings.

The APEC finance ministers has unrealized potential, but too many and diverse players to engage in effective consultation and peer review. Ecotech is its "long suit". Even there, its topical list is so long as to indicate any priorities and no project ever seems to get finished. Hence, process seems to be its main accomplishment. Having said that, it was also noted that the dialogue on Corporate Governance in Financial Markets was an effective process.

Leadership is seen to be provided by the United States in the IMF. Leadership the Framework Group and EMEAP is less clear. Japan, at least for now, provides the leadership in the ASEAN + 3.

With respect to leadership from national ministries and central banks, the central banks in Hong Kong and Singapore are seen to take the lead while treasuries take the lead in delegations from most other economies.

Why does EMEAP work as well as it does? Part of the answer is that it has a reasonably homogeneous membership and focused technical mandates to develop what one might call the financial "plumbing" -- the market linkages among member economies and stronger oversight of markets.

### **C. Regional Cooperation**

As indicated above, EMEAP seems to be furthest along the spectrum towards cooperation and to provide the foundations for closer regional cooperation. ASEAN+3 also looks promising in that the swap agreements under the Chiang Mai Initiative are moving along, but it was pointed out that the mechanism has yet to be tested. When that test of its ability to head off or manage a crisis occurs, it could provide a negative example of cooperation.

Some skepticism was expressed about existing techniques for monitoring economic policies and performance. Early-warning indicators don't work particularly well because

of the lags involved. Indeed, one interlocutor noted that common sense works better. Nevertheless, neighbors should be talking to each other and any means to promote dialogue and consultation are desirable. But it is the IMF that should flag future financial crises, since these are likely to be global rather than regional.

Who monitors economic performance? Obviously, IMF Article IV surveillance is the best-developed routine, and one that has been updated in the wake of the 1997-98 crises to include ROSCs, FSAPs and adherence to SDDS. Does it really make sense to replicate this process and these standards and codes in a regional group? There is an ADB group that provides analysis, but there seem to be questions, possibly about its mandate.

Positive examples of cooperation:

- The APEC finance ministers dialogue on corporate governance in financial markets;
- The Regional Training Center in Singapore;
- ASEAN + 3 swap agreements;
- EMEAP activities.

Negative examples: the APEC finance ministers and the Manila framework group have failed to produce effective levels of technical assistance.

#### **D. Reforms**

In general, it was felt that efforts to build the basic groundwork for consultation and to develop cooperative links should continue. More generally, all PECC economies should build support for market-opening and financial integration. Over the longer term, reducing regional trade barriers should receive greater emphasis as a necessary precursor to financial integration, whether within Asia or Latin America or within the PECC. Furthermore, strengthening domestic financial systems is a sine qua non to closer monetary cooperation.

More specifically, a decision is needed on whether to keep the Manila Framework Group or kill it. The APEC finance ministers need a more differentiated (complementary) mandate, given recent developments such as ASEAN + 3.

From a more academic perspective, ASEAN+3 is seen to have considerable potential as a vehicle for financial cooperation (and closer monetary cooperation conditional on how CMI evolves), but needs to become more definitive with respect to:

- Wider membership; it should include Australia, New Zealand, Taiwan and Hong Kong because of their clout in the region (and relative global significance);
- Credible surveillance mechanism; it should deepen its links with the IMF and also consider organizing itself into a 2-speed mechanism. “Core” economies (the ones that are the most market-oriented ) would accelerate progress on surveillance and cooperation to demonstrate how it can work;

## **E. Linkages between regional and global financial institutions institutions**

The IMF link with regional institutions is critical as most financial crises in future are likely to be global. As noted above, the IMF has the best developed surveillance capability and will be expected by most to manage the next crisis wherever it may occur. IMF linkages are already important for APEC and the Manila Framework Group. The IMF link is not clear for ASEAN +3, and undesirable overlap or conflict could contribute to distortions that undermine the credibility of both institutions.

From an academic perspective, ASEAN+3, if it gains more credibility, can provide leverage for dealing with the under-representation of East Asians in the IMF. These economies should push for appropriate IMF reforms to give them greater clout in the institutions, and be prepared to provide leadership with opportunities arise.

## **F. Conclusion**

In conclusion, the official Canadian perspective focuses on economic fundamentals of financial and monetary cooperation -- strengthening domestic financial systems and removing barriers to trade and financial flows -- and on changing the incentive structures for governments and financial market participants in order to remove distortions and imbalances that cause financial crises.

The academic perspective emphasizes the potential importance of ASEAN+3, as a credible vehicle for financial cooperation and peer pressure needed for successful crisis prevention and management, and as a lever for gaining more clout in the IMF. But it needs to evolve by deepening technical support, widening its membership, and accelerating cooperation efforts among the most market-oriented members.