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

**Session II: ASEAN Plus Three Perspectives**

Country Perspective Paper: Thailand

**Regional Financial and Monetary Cooperation  
in East Asia: Thailand's Perspective<sup>I</sup>**

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## **A. Introduction and Overview**

An important lesson drawn from the financial crises in East Asia during 1997-1998 is that the sudden reversals of capital flow has been at the root of recent financial crises. Although many East Asian countries had enjoyed capital inflows in supporting the incredible economic growth during the period called “East Asian Miracle”, the sudden reversals of the foreign “hot” money led to a severe economic collapse in many East Asia countries. The IMF, in the 1998 world economic outlook, estimated that emerging countries suffered, on average, 8 percent losses in output during a severe crisis. The financial crises in East Asia during 1997-1998, thus, have raised a great interest among East Asia countries in strengthening financial cooperation and monetary cooperation in protecting themselves from disruptive foreign capital movements and preventing financial crisis from reoccurring. This study aims to provide an overview of regional financial cooperation in East Asia and analyze the degree of cooperation in regional financial institutions from the perspective of Thai officials<sup>1</sup>, and to propose institutional reforms for strengthening regional financial cooperation in East Asia.

## **B. Regional Financial Institutions**

Following the financial crisis in East Asia, the establishment of a system of regional financial cooperation began to receive mounting recognition and credibility, apart from the already existing system of regional trade cooperation. The success of the speculative attacks on East Asian currencies, which triggered the collapse of several

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<sup>1</sup> This study is based on the information provided by the Ministry of Finance and the central bank officials who have been working in the area of financial cooperation. In Thailand, the finance ministry and central

economies in East Asia, was a clear proof of inadequate cohesive financial cooperation in the region. During the time of the crisis, the crisis-hit countries had to wait for financial assistance that came rather short and late from international financial institutions. In case of Thailand, an attempt to request funds from Japanese government at the beginning of the crisis was rejected due to the lack of clear information on the crisis situation in Thailand. However, Japan ultimately became a major contributor in the rescue package for Thailand of the IMF. Due to the insufficient financial resources for borrowing in times of massive capital outflows, the Thai crisis was contagious to other East Asia countries as massive capital flew out from the Philippines, Malaysia, Indonesia, and South Korea. The crisis in East Asia indicates a clear need to establish regional financing cooperation that could enable member countries to cope with potentially disruptive international capital movements to protect themselves from volatile capital movements.

Since the Asian financial crisis in 1997, there have been various other regional and international institutions that paid more attention to financial cooperation. Examples of international institutions and their financial cooperation are described as follows:

#### ASEAN

Immediately after the outbreak of the Asian financial crisis, Japan floated the idea of establishing the Asian Monetary Fund (AMF). However, the idea was strongly rejected by the IMF and the US. A year after the idea of AMF was shot down,

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bank officials are usually well coordinated to have a common stand in a meeting of regional financial forums. During the meeting, one may take a lead in accordance with its responsibilities.

ASEAN<sup>2</sup>, led by the five founding member countries –Thailand, Malaysia, the Philippines, Singapore, and Indonesia, formulated the ASEAN Finance Minister Forum to oversee the ASEAN Financial Work Program. In the program, there were new activities to ensure sound international financial practices and standards, to deepen capital markets, to improve corporate governance among member countries, and, perhaps the most important, to find the way for Asian Financial Arrangement. The key objective of the Program was to prevent ASEAN from entering into another financial crisis.

ASEAN also established the ASEAN Surveillance Process (ASP) to keep track of the global, regional, and national economic and financial progress and to signal a warning signal of economic vulnerability. The National Surveillance Unit in each member country is required to semi-annually submit a set of economic data to the ASEAN Surveillance Coordinating Unit (ASCU), set up under the ASEAN Secretariat in Jakarta. The ASCU would then produce the ASEAN Surveillance Report that analyzes the most recent economic development and raises important issues for the consideration of ASEAN Finance Ministers Meetings (AFMM) during their peer reviews<sup>3</sup>. The recent assessment of the ASCU by the member countries was positive as it provided a good networking system of assigned country surveillance units in the member countries. The last AFMM meeting in April 2002 approved the establishment of a new financial unit in the ASCU.

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<sup>2</sup> ASEAN, composed of 10 member countries, namely, Thailand, Indonesia, Malaysia, Singapore, the Philippines, Brunei, Cambodia, Vietnam, Laos, and Myanmar, has long history focused more on political cooperation since the establishment in 1967. After the end of cold war, it extended its focus to economic cooperation in the area of trade, investment, industry, human resources, and tourism.

<sup>3</sup> The first peer review took place in March 1999. Since then, there have been six surveillance reports, and the last one was submitted to the AFMM in Rangoon, Myanmar, in April 2002.

The ASP also provides closer links between regional financial institution and the international financial institutions, especially the Asian Development Bank (ADB). The ADB also helped the ASEAN Secretariat to develop an Early Warning System (EWS) prototype for the region comprising four major components as follows: a set of macroeconomic prudential indicators; a nonparametric EWS model; a parametric EWS model; and a set of leading economic indicators of business cycles. In this regard, the set of macroeconomic prudential indicators includes current account balance to GDP, current account balance to investment, fiscal balance to GDP, short-term capital flows to GDP, real exchange rate appreciation relative to trend, export growth, and ratio of M2 to international reserves.

#### ASEAN +3 and Chiang Mai Initiative

While the ASEAN, through the ASP, became an important information base for the ASEAN monitoring and warning system, the Chiang Mai Initiative (CMI), announced by the ASEAN + 3 Finance Ministers Meeting (AFMM+3) during the ADB Annual Meeting in Chiang Mai, Thailand in May 2000, represented an important policy movement in self-reliance in the context of a regional financial arrangement. The CMI was aimed to strengthen self-help and support mechanisms in East Asia through the ASEAN +3 (China, Japan, and South Korea) Framework by establishing a regional financing arrangement to supplement the existing international facilities. The CMI involved the expansion of ASEAN Swap Arrangement (ASA) to include all ASEAN Countries and to increase the size of the facility, and the creation of a new network of bilateral swap and repurchase agreement facilities between the ASEAN countries and China, Japan, and South Korea. To date, the ASA has been expanded to include all the 10 ASEAN countries. The total facility has been increased in size from USD 200

million to USD 1,000 million since November 2000. The eight Bilateral Swap Agreements (BSA) have been successfully concluded with a combined size of USD 17 Billion. Six agreements are under negotiation. Thailand, as the front-running country, has concluded the bilateral agreements with Japan in the amount of USD 3 billion, with China in the amount of USD 2 billion, and with South Korea in the amount of USD 1 billion. The first two agreements are a one-way direction agreement, which Japan and China are positioned the lender to Thailand. The last agreement with South Korea is a two-way direction agreement, which South Korea is able to borrow from Thailand as well.

Since the surveillance system and conditionalities of the ASEAN +3 are not up to the level where members of ASEAN +3 would feel comfortable enough, the BSA facility relies on the IMF surveillance and conditionality. In order to utilize more than 10 percent of the agreed swaps line, the borrowing country must first enter the IMF rescue program and conditionalities. Although the CMI of the ASEAN +3 is the self-help financial facility for East Asia, it is clear that the CMI is in an early stage of development and have to depend on conditionalities and facilities of international financial institutions especially those of the IMF.

#### Manila Framework Group

Manila Framework Group, led by U.S.A. and IMF, was initiated in 1997 in order to strengthen financial cooperation for financial stability in Asia after financial crisis occurred. The First Meeting was held in Manila, Philippines during November 1997. It is composed of representatives from international financial organizations, central banks, and Ministry of Finance from various countries in Asia and Pacific (Australia, Brunei,

Canada, China-PRC, Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, Philippines, Singapore, United States, and Thailand). The discussed agenda mainly involved with regional surveillance, financial and corporate sector restructuring, reform of international financial system, and review of Manila framework financial arrangement. The Manila Framework can be viewed as a discussion forum without any government commitment. Therefore, the forum focuses more on exchanging members' view than preceding the real action, that should contribute to the deeper and substantial cooperation.

#### Executive Meeting of East Asia and Pacific (EMEAP) Central Banks

EMEAP, initiated by Japan since 1991, was especially found as a central bank forum. At the beginning, EMEAP was limited to a meeting of central bank deputies, but it has been upgraded to cover central bank governors meeting since 1996. Its objectives are to discuss and to exchange information about the recent economic and monetary development within the region, including the role of the central banks. Member countries are Australia, China-PRC, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. Because the EMEAP is limited to central banks of the member countries, it has received less attention than other institutions in the national agenda.

#### APEC Finance Minister Meeting (APEC FMM)

APEC Finance Minister Meeting was initiated in 1989 as proposed by Australian Government in order to discuss and exchange views regarding the region's macroeconomic policies and fiscal and financial issues. The first APEC FMM was held in March 1994 in Hawaii, U.S.A. among 21 member countries in Asia-Pacific region

(Australia, Brunei, Canada, China-PRC, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Russia, Singapore, Chinese Taipei, Thailand, U.S.A., and Vietnam) together with international financial organizations. The recent key issues have been related to the exchange of views regarding macroeconomic challenges and policies response to the crisis, strengthening the international financial system through international financial architecture reform, and policy initiatives covered many areas such as fighting financial crime, pension fund, and APEC Future Economic Leader Think Tank for supporting economic and financial stability. As APEC adopted voluntary basis to be the key principle, the APEC forum can play a crucial part of consultation.

The Pacific Economic Cooperation Council (PECC), which is the only non-governmental official observer of APEC, may play a greater role in raising support for East Asia financial arrangement in APEC, and put forward the progress reports and issues regarding the regional financial arrangement in the APEC Leaders Meeting. Also, the PECC can provide technical support and research to strengthen financial cooperation and economic surveillance in the Asia Pacific region.

#### ASEM Finance Minister's Meeting (ASEM FMM)

ASEM FMM was established in September 1997 to strengthen financial cooperation between Asia and Europe. The first meeting was held on 19 September 1997 in Bangkok. The meeting comprises of 10 Asian member countries and 15 European member countries (Austria, Belgium, Denmark, France, Finland, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK, European Commission). The current agenda are issues involving with (1) economic



development in Asia Europe and the rest of the world particularly emphasizing on structural reforms in Asia and EU, (2) combating the financing of terrorism, money laundering and abuses of the global financial system, (3) Kobe research project, which supports the creation of recommendation on regional cooperation in the financial field, and (4) ASEM trust Fund. ASEM cooperation is based on a partnership strategy. Member countries always use the forum to share the different experiences between Asia and Europe regions.

In the aforementioned institution set up, the ASEAN and ASEAN +3 have the highest potential of better enabling the region to deal with potential crisis while other institutions could be key supporters for regional financial cooperation. At this current stage, governments are willing to work together through consultation among one another or through producing joint studies but the driving force for implementation in views of the East Asian countries is currently based on the ASEAN +3 institution. However, as cooperation and surveillance system become more complex, there will be an increase in demand for outside help and support. For example, if we focus on the swap arrangement alone, the ASA and BSA under the CMI are only a starting point of creating self-help facilities that serve as the “first line of defense” against a possibility of a balance of payment difficulty. At this stage, outside helps to identify the good surveillance system and way to increase the 10 percent threshold of borrowing without IMF’s conditionalities are already welcome. In the future, these might be the second line and third line of defense<sup>4</sup>. As a result, there will be no shortage of demand for

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<sup>4</sup> See, for example, Dr.Olarn Chaipravut’s study on “the core study on Financial Resource Pooling and Provision, Alternative Conditionalities and Surveillance Institutional Set-up under the Basket Peg Exchange Regime for East Asia”.

external assistance and support. Cooperation at this size of complexity requires good understanding both inter and intra region.

In sum, the success of the CMI, a milestone in financial cooperation the ASEAN +3 region, shows the potential for promoting deeper financial cooperation in the region. It is expected that going forward towards the formation of Regional Financial Arrangement for the ASEAN + 3 will involve an exploring of alternatives to formalize some form of an ASEAN Currency Fund and a movement towards the building of a single currency, the so-called Asian Currency Unit (ACU). The next section will focus on the issue on what institutional reforms under the ASEAN +3 Framework that are needed to move towards closer monetary cooperation to lay the basis for reducing currency volatility in the region and, possibly in the long term, for a common currency.

### **C. Regional Financial Cooperation and Institutional Reform**

There is a need to enhance institutional capacity of the ASEAN +3 to promote closer regional financial cooperation. Currently, the ASEAN Secretariat, with its limited funds and personnel, acts as a secretariat for the ASEAN and ASEAN +3. Since it has had to engage itself in various types of activities, including regional security, ASEAN Free Trade Area, and etc, the limitations may soon become a boundary to the progress in the regional financial arrangement. At this stage, the devoted ASCU plus supporting resources from the ADB and the technical support from the IMF seem sufficient to manage the on-going ASEAN Finance Ministers Meeting. It would however be a great improvement if the ASEAN+3 could have its own well-coordinated institution with a clear mandate to provide supplementary technical analysis specifically for the prevention of next crisis.

In fact, the need to enhance institutional capacity of the ASEAN+3 has been of concern among member countries. Recently, at the AFMM meeting in Rangoon in Myanmar, Bank Negara of Malaysia and the Ministry of Finance of Japan, in a joint paper on “Possible Modalities to Enhance the Effectiveness of Economic Review and Policy Dialogues among the ASEAN+3 Countries”, proposed a two- phase development.

For Phase I, an additional informal ASEAN+3 Finance and Central Bank Deputies’ Meeting (Informal AFDM+3) was proposed to “focus on economic reviews and policy dialogues in greater depth”. The secretariat function will be performed on a rotation basis. A review of the meeting’s effectiveness will be carried out after one year. The phase I proposal was endorsed by the AFMM.

For Phase II, the proposal went to great lengths to propose a permanent economic review and policy dialogue, which would include an independent “third party” to perform an in-depth, quality assessment. The proposal revealed the necessary steps to include the improving of the capability of the ASEAN Secretariat and the setting up of a Working Group of Eminent Persons (EPG). As it turned out, the Phase II proposal did not receive approval due to insufficient clarification. It will be considered again in the next AFDM+3.

We support an attempt to improve intellectual capacity of the ASEAN secretariat by setting the Eminent Person Group (EPG). The EPG, composing of a group of respectable and competent people who are authorized to execute and oversee policies

that agreed upon among member countries, would provide a necessary input and a long-term vision and possible cooperation agenda for the ASEAN+3 or an assessments of ongoing policies of member countries.

However, it is necessary to have a permanent “Technical Forum”, providing intellectual and technical analysis to the EPG. Currently, the surveillance system of the ASEAN Surveillance Process has moved close to reflecting the present economic situation of the member countries. Yet a rigorous technical analysis, designed specifically for policy initiative for the region, seems to be missing. A strong technical analysis does not mean to raise an unnecessary controversial issue to the attention of politicians or to criticize policy of a government in particular. It would instead reflect the possible impact, position, and policy coordination of the ASEAN+3 as a group. Without the capability to express strong and credible technical analysis, the surveillance and warning system cannot go further than a combined country review and warning via key indicators from past data reported by the Surveillance Unit.

The Technical Forum, as may be named as the East Asian Regional Financial Arrangement (EARFA) Forum, may be composed of policy research institutes or top policy researchers of the ASEAN + 3 member countries. The tasks are to provide in-depth technical studies of the current situation in supplement of the Surveillance Report, to raise issues regarding the next steps to be taken towards closer financial cooperation in the ASEAN+3, and to provide academic and non-binding policy alternatives for decision makers. The issues would include the identifications of important changes in the ASEAN+3, new regional financial architecture, and pre- and post-crisis conditionalities.

One must keep in mind that the EARFA Forum, if established, would have only an objective to enhance the analytical capacity of the ASEAN Secretariat and work hand-in-hand with the EPG. Studies, technical analyses, policy options provided by the EARFA will be first reviewed by the EPG and later submitted to the regular process of ASEAN + 3 Finance Deputies Meetings (AFDM +3) and ASEAN + 3 Finance Ministers Meeting (AFMM +3) before being proposed to the ASEAN+3 leaders. Commitment of continuing support from the ADB, IMF, World Bank, and other international financial institutions are vital to the success of the EARFA Forum.

In addition to establish the EARFA Forum, stronger surveillance system and conditionalities are necessary keys to step beyond the CMI. Without them, a member country in the ASA, given its limited knowledge of other countries' economic and political situation, may hesitate to extend the current size of the ASA facility. Similarly, major contributors like Japan and China would still need reliable information and knowledge about ASEAN economies before it can extend the BSA beyond the current limit. Thus, without better surveillance system and conditionalities among ASEAN +3, the truly self-reliance mechanism of the CMI would not have gone further than a complement facility of the existing international facilities.

The above suggestions for institutional reform are general requirements for moving towards closer cooperation. However, the institution reforms to lay the basis for lessening currency volatility in the region and for a common currency in the long term will depend on the ways the member countries choose to continue. A number of questions must be answered first before setting up a corresponding institution. For

example: What exchange rate regime would all member countries be willing to adopt together (Strong peg or loose peg)?; should the currency be pegged with one currency or with basket of currencies (then with what currencies)?; and how much resource should be mobilized, managed, and used in a collective manner among member countries to maintain and defend their coordinated exchange rate regime? The answers to these questions are beyond the scope of this paper and will be left for future research. Once we have the clear answers to these questions, then the institutional reforms should be done in such a way that promote a better coordination among members to achieve the same goal.

#### **D. Conclusion**

Since the Asian currency crisis, a regional financial cooperation has been in the spotlight of discussions among East Asia countries. The Chiang Mai Initiatives, as a self-help mechanism for ASEAN +3 countries, was a significant step forward for financial cooperation among East Asia. The Initiative aims to collectively combine the financial resources to increase the funds available for borrowing when member countries experience short-term liquidity problems. With a strong coordination among members of ASEAN +3 countries, which also have the largest combined reserves, the ASEAN +3 has the best potential for deeper cooperation in preventing a crisis in the region. However, due to limitations of the ASEAN Secretariat, there is a need to enhance institutional capacity of the Secretariat to promote closer cooperation. The new institutions of Eminent Person Group with the help of Technical Forum, the so-called EARFA, are suggested to be set up for monitoring, policy making, and providing a long-term vision for the ASEAN +3.

In the process of creating regional financial and monetary cooperation in East Asia, relevant institution of forum like PECC could play a major role in supporting technical analysis to enhance knowledge of ways and means for better cooperation. The PECC is quite an appropriate forum in supplying the knowledge, required by East Asia Nations, with experts of academic, business and government from the 25 member countries in the Asia Pacific region. Moreover, East Asia cannot move unilaterally toward these ends. The understanding at the global scale needs PECC's promotion especially in the APEC forum.