STEPPING UP ASIAN FINANCIAL CO-OPERATION

Even as Europe accelerated its drive to realise a monetary union and North America, a free trade area, East Asia still showed lukewarm political determination when it came to synchronising the region economically. Things changed in July 1997 when a financial crisis hit many Asian countries. Thereafter, East Asian countries started to demonstrate a clear commitment towards greater development co-operation, including monetary and financial co-operation, in order to protect the region from a similar crisis in the future. Dr Marie-Aimée Tourres reports on session three (held on 5 August 2003) of the three-day Congress.

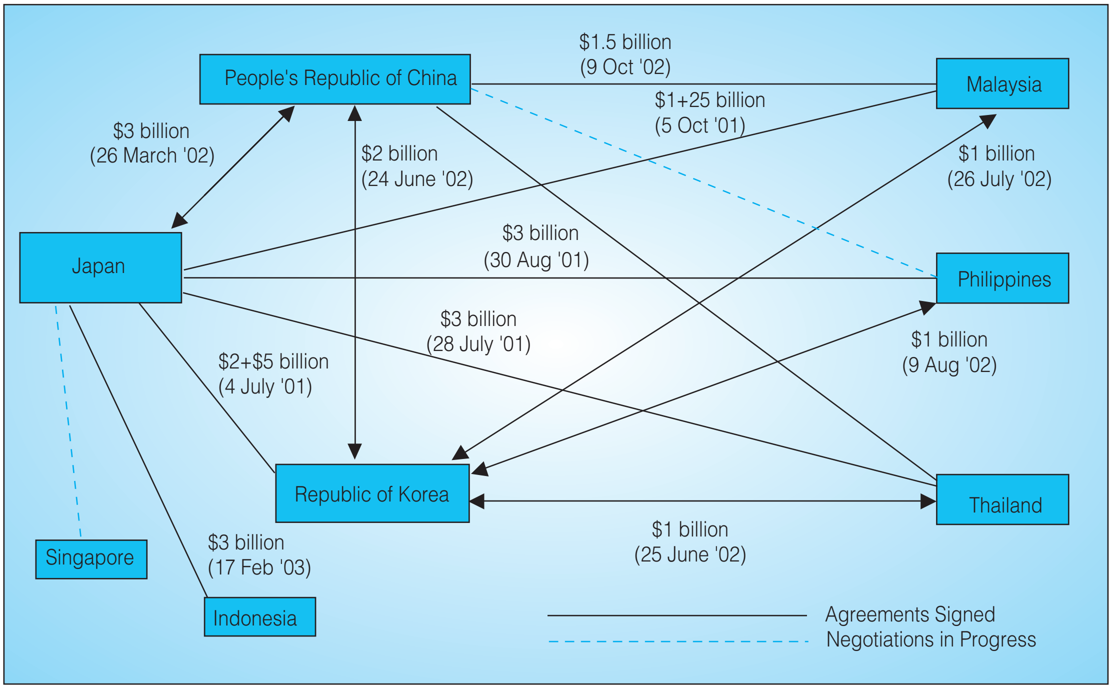
Prof. Kiyohiko Fukushima of Japan.

The 1997 Asian financial crisis may have acted as a catalyst to spur countries in the region to work much more closely together on financial and monetary matters for the interest of the region as a whole, but a high dose of political will is still needed to fully realise the Asian dream of full financial co-operation. A commitment to East Asian co-operation, through an East Asian community is the first step to go. As Tan Sri Dr Noordin Sopiee, Chairman and Chief Executive Officer of ISIS Malaysia said earlier in the Congress, "It is not a question of personality, but a matter of reality and logic. Obviously, everybody is committed."

On the financial side, much progress has been made on regional co-operation since the crisis. At present, there is not much need for long-term development financing in the region as most countries in the region have current account surpluses, but nevertheless it is important to prepare for future financial cooperation and to set clear priorities.

After the abortion of the Asian Monetary Fund (AMF) proposal in September 1997 (see article "The case for and against an AMF"), five Asean countries – Indonesia, Malaysia,

ASEAN+3 Bilateral Swap Arrangements as at February 2003



Philippines, Singapore and Thailand – agreed to establish an Asean Swap Arrangement (ASA), a short-term liquidity support facility for the participating countries suffering balance of payments difficulties. In November 1999, in Manila, the Asean+3 group first made a formal Joint Statement on East Asian co-operation at the Asean+3 summit which subsequently led to the Chiang Mai Initiative (CMI) announced in May 2000 in Chiang Mai, Thailand. The total amount of the facility was then raised by US$1 billion from the initial amount of US$200 million under ASA.

Chiang Mai Initiative

The CMI has two components: (1) an expanded Asean swap arrangement of foreign exchange reserves, and (2) a network of bilateral swap agreements (BSA) and repurchase arrangements among the 13 countries to provide liquidity support (see chart).

The BSA allows an immediate disbursement of up to 10 per cent of the maximum amount of drawing, but countries drawing more than the 10 per cent, are required to accept an IMF programme for macroeconomic and structural adjustments. A number of the participating countries have expressed their reservation concerning this BSA-IMF linkage. (At the Asean Finance Ministers' meeting in April 2001 in Kuala Lumpur, however, there was consensus that the BSA should remain complementary and supplementary to IMF facilities until a regional surveillance system is brought into existence. The participating countries agreed to review the issue of the IMF linkage and other main principles in May 2004.)

Nevertheless, despite the CMI's limitations (that is, current allowable amounts being too small to be significant in the case of insolvencies and being too closely tied to the IMF) – it is a significant symbolic initiative, given the region's socio-economic diversities and historical baggage.

Asia Bond Fund

More recently, in June 2003, the 11 East Asian central banks established an Asia Bond Fund (ABF) by collecting a total of US$1 billion to invest in the bonds issued by the public sectors of the eight countries in East Asia (including China, Korea, Hong Kong, Indonesia and Thailand).

The advantages of the ABF, as pointed out by Gan Kim Khoon, Executive Director of AmResearch, Malaysia are to: (1) recycle part of the region's high level of savings to finance productive activity within the regional economies, (2) facilitate the channelling of a small portion of the sizeable official reserves held by the Asian economies back into the region, (3) pose another option for Asian central banks to diversify their investments beyond the more traditional reserve assets to enhance their returns, and (4) promote bond markets in the region by investing in a basket of US dollar-denominated bonds issued by Asian sovereign and quasi-sovereign issuers.

The ABF is a good initiative, noted Prof. Kiyohiko Fukushima, Chief Economist at Nomura Research Institute, Japan, but its current set-up has some limitations. First, the Fund can only invest in US dollar-denominated securities. As a result, the ABF cannot resolve the insolvency crisis of the bond issuer when a local Asian currency suffers a sharp fall. Second, the passive investment policy (that is, to just buy and hold bonds until maturity) to be adopted by the ABF will not result in deepening and activating the bond market in Asia.

Dr Cho Jonghwa of Korea saw difficulty in introducing a single Asian currency in the foreseeable future.

According to the speakers, the ABF can help promote the use of regional currencies or an Asian basket currency.

A common Asian currency

Considering the diverse macroeconomic environment and individual monetary policy objectives of the East Asian countries, it would be difficult to introduce a single Asian currency in the foreseeable future, said Dr Cho Jongwha, Director of the Korea Institute for International Economic Policy (Kiep). His view was shared by the other three panelists responding to numerous questions on the issue from the floor. Barring this fact, other regional financial co-operation efforts to improve integration could still go on.

Dr Chalongphob Sussangkarn, President of the Thailand Development Research Institute pointed out that one could lessen dependence on the US dollar by developing an effective alternative to the latter as the main trade and settlement currency and realising such an alternative could be to make the yen a more effective international currency. Currently, most regional currencies have no direct exchanges with the yen and need to transact through the US dollar. Thus, the first step would be to develop yen-local currency markets and to denominate more trade between Japan and Asian economies in terms of yen. One stumbling block to this proposal is that many Asian countries still rely on the US for security reasons.

Other co-operation avenues

East Asia has vast financial resources. Joint policy decisions

Dr Chalongphob Sussangkarn of Thailand.

Dr Fong Cheng Hong, Managing Director of The Development Bank of Singapore, chaired the session.

could be made as to how to tap and invest this saving surplus. In fact, numerous areas of financial co-operation had already been identified for further action. These areas included: regional credit rating; harmonisation of rules, regulations and taxes; settlement and clearing mechanisms; credit guarantee mechanisms; development of asset-backed securities; Asean surveillance process on macro-economic management; capital flows monitoring; capital market development; and the promotion of Asean currencies for intra-Asean trade. The position of emerging East Asian countries on the issue of exchange rate policy co-ordination should also be established. With the exception of China (8.28 yuan = US$1) and Malaysia (RM3.80 = US$1), Asian countries had floated their currencies against the US dollar, resulting in their economies being affected by volatile movements in the foreign exchange markets. There is thus a need for intraregional exchange rate stability. (Note that since China is the largest factor in the US deficit, China is being pressured by the US to re-evaluate its currency, a move strongly opposed by Prof. E. Sakakibara, see article "The case for and against an AMF.")

Gan brought out the issue of money laundering and stressed that Asian countries must co-operate to facilitate cross-border investigations, as well as evolve a high level of appreciation of law enforcement issues in this fight.

Assuming East Asian politicians continue to show commitment in promoting greater financial co-operation, a new regional monetary organisation, such as the AMF, might come about. Also, the idea of creating an Asian Monetary Institute was raised, not only during the session but also many times during the Congress by many participants. Prof. Fukushima said that expertise is important, but, more importantly, East Asian policymakers and the general public should have a greater common understanding about Asia's financial affairs. Towards this end, the establishment of an Asian Monetary Institute could represent a necessary first step in enabling more exchanges of views on the practical steps for implementation and more collaboration on the dissemination of information on international finance.

Comments from the floor and from the panelists stressed the need to, first and foremost, obtain agreement on priorities before moving on to clarifying the rationale for regional financial co-operation, and concentrating on co-ordination efforts. ●