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Second East Asia Congress

Monetary and Financial Cooperation: Specific Proposals for East Asia

The Asian Crisis of 1997-98 made it painfully clear that monetary and financial cooperation in the region at the time was inadequate. Six years on, what lessons have been learned? This session discussed specific proposals for improving cooperation, including information sharing and surveillance, swaps and other regional financing arrangements, regional bond markets, and coordination of exchange rate policies. ***Dr Marie-Aimée Tourres*** *reports.*

This session on monetary and financial cooperation was chaired by Datuk Latifah Merican Chong, Assistant Governor, Bank Negara Malaysia. The speakers were Dr Olarn Chaipravat, Honorary Advisor, Fiscal Policy Research Institute, Thailand; Prof Kiyohiko Fukushima, Chief Economist, Nomura Research Institute, Japan; Gov Gabriel Singson, Chairman, JG Summit Capital Markets Corp, Philippines; and Prof Jong-Wha Lee, Director, International Centre for Korean Studies, Korea University.

Emerging Asian countries learned several lessons from the Asian Crisis of 1997-98. The first lesson was to avoid the “double mismatch” problem, namely currency and maturity mismatches of borrowers in emerging market companies (i.e. borrow short in the US dollar, and invest long in local currency-earning projects). The second lesson was to avoid over-reliance on the banking sector. The third lesson was to avoid the dollar peg that tends to make the real effective exchange rate fluctuate too much.

With this in mind, what are today's specific proposals for improved monetary and financial cooperation in East Asia?

Current initiatives

The issue of a common currency may have been widely discussed in relation to regional economic integration at various points in the past, but at this session all panelists agreed that its establishment should now clearly be considered only as the final stage. The reason given by Prof Lee was that it requires many preconditions, the four most important being: further integration in the goods and services markets; greater integration in the labor market; greater integration in the capital market; and participating countries’ economic similarities. In East Asia, these conditions have not been fully met.

As a consequence, the initiatives to strengthen regional monetary and financial cooperation now generally fall under four other broad areas highlighted by Gov Singson: (1) information sharing, policy dialogue and economic surveillance; (2) regional financing arrangements; (3) development of regional bond markets; and (4) coordination of exchange rate policies.

Information sharing and economic surveillance

Steps have been taken for cooperation in monitoring short-term capital flows and developing a regional early warning system to assess regional financial vulnerabilities. There is now a need to go beyond this, and strengthen the ASEAN+3 surveillance process as stressed by Prof Lee. Along these lines, Gov Singson suggests that a formal institutional structure be established to coordinate the implementation of financial and monetary integration activities in East Asia.

Swaps and other regional financing arrangements

The Asian Crisis of 1997-98 remains among East Asia's darkest moments in recent memory. Not surprisingly, all speakers agreed that East Asia should keep working on developing a regional financing facility that would provide international liquidity in times of currency attack and/or crisis.

Under the "Chiang Mai Initiative" (May 1999), it was agreed that a regional network of bilateral swap arrangements (BSAs) be established in addition to the existing ASEAN swap agreement (ASA). By providing financial assistance to countries in need of balance of payment support or short-term liquidity support, the BSAs are to supplement existing international financial facilities (such as the IMF, and the ASA).

Since the First East Asia Congress in August 2003, four more BSAs have been concluded, bringing their total number to 16 with a combined size of US$36.5 billion. However, Gov Singson pointed out that "the relative effectiveness of BSAs is limited by the linkage of the IMF programme as it defeats the purpose of a quick disbursing scheme. The challenge is therefore to delink the BSA from the IMF."

Less from banks, more from bonds

The Asian Crisis also highlighted the need to rely less on bank lending. Consequently, other proposals to foster economic cooperation among East Asian countries have emerged. For reducing over-reliance on banks, one obvious way is to promote bond financing. If borrowers – the government and corporations – can issue bonds, then they can lower the ratio of borrowing from banks. To this end, Asian bonds have been proposed, and have in fact become a focal point for regional financial cooperation after the Chiang Mai Initiative (CMI). Several ideas under this banner have been discussed among policymakers and academics in the region. The idea is to enable the public and private sectors to raise and invest in long-term capital without the double mismatch (currency and maturity) risk.

In this respect, the Asian Bond Market Initiative (ABMI) was set up in 2002. Subsequently in June 2003, the Asian Bond Fund, a regional investment fund investing in bonds denominated in the US dollar, was established by 11 East Asian central banks. According to Prof Fukushima, "Though the initial step is too mild to have any significant effect, this is a right step. Taking the step toward developing an international bond market in East Asia will facilitate currency stability and economic growth in the region."

That said, the Asian Bond Fund in its current form has severe limitations. Prof Fukushima highlighted three. First, the Fund can only invest in US dollar-denominated securities (it therefore cannot resolve the insolvency crisis of the bond issuer if the sharp fall occurs in the local currency). The second limitation is the existence of a maturity mismatch between borrowers and lenders. Lastly, the passive investment policy (buy and hold bonds till maturity), can neither deepen nor activate the bond market in Asia.

To overcome the above limitations, Prof Fukushima described a possible solution (proposed by Prof Ito of Tokyo University), that is the establishment of a new entity that could be called the "Asian Bond Corporation" (ABC). It would create a bond market composed of a mix of regional currencies (50 percent Japanese yen, 20 percent Thai baht, 30 percent South Korean won), for the purpose of shifting Asian savings into investments in Asian infrastructure. The operation of the ABC could be expanded over the years and as it moves forward, the introduction of the Asian currency unit could become more feasible.

Indeed, from the various panelists' presentations, it was clear that a real wish exists to achieve a "detachment from the dollar" by sharply reducing its weight and increasing that of the Asian ones. "That is the current state of the grand design for regional currency cooperation toward a common currency unit, contemplated by the policy deliberating community in Japan and in Asia," said Prof Fukushima.

Another initiative in the development process of the bond markets is currently being taken by Thailand. In November 2003, Thailand announced its plan to issue the first series of the "Thai-baht Asian Bonds" by 2004. The preliminary features were presented by Dr Olarn. The market for issuance would be onshore, whereby the bond itself would be a sovereign bond with two to ten years maturity, with an issuance size of up to 30 billion baht. The issuance shall be done regularly every six or 12 months for the next five years to create benchmark yield curves. A fixed coupon payment (about 4.5 percent per annum for a ten year-maturity at current rates) will be paid semi-annually. In connection with this, the appropriate tax treatment would be implemented, namely the exemption of withholding tax on interest payments and capital gains as well as the lifting of foreign exchange restrictions. This is to follow the path of other ASEAN+3 countries such as Hong Kong, Taiwan, Japan and Singapore, which have relatively more sophisticated domestic bond markets. It is also to encourage other ASEAN+3 countries, whose withholding taxes still exist, to find an appropriate solution in gradually removing withholding taxes on debt instruments from their respective domestic bond markets.

Among the other recent developments discussed was the launching of the AsianBondsOnline Website (ABW) during the ASEAN+3 Finance Ministers Meeting on 14-15 May 2004 in Korea. The ABW should play an important role in providing the public with information about the bond markets in the region, as well as updates on the progress made by each working group under the ABMI.

More coordination on exchange rate policies

Lastly, a good financial environment requires coordination on exchange rate policies. Following the Asian Crisis of 1997-1998, there has been no major currency crisis in Asia that has resulted in an equivalent degree of economic disruption. Nevertheless, beneath the calm surface, the pressure for a major currency realignment is mounting.

Some efforts are underway in East Asia to begin coordination on exchange rate policies, such as the establishment in March 2001 of an ASEAN Task Force on ASEAN Currency and Exchange Rate Mechanism. The Task Force conducted a recent study on forms of regional cooperation to promote currency stability. Yet, according to Gov Singson, “the best that can be achieved for the present is to ensure the consistency of macroeconomic fundamentals and sustain structural reforms. Dialogue, on the choice of exchange rate regimes and exchange rate policies, will help authorities understand better the exchange rate policy of each country in the region.”