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Taking Stock of Monetary and Financial Regionalism in Asia

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1. What is Regionalism?

- Regionalism is a "(b)ody of ideas promoting an identified geographical or social space as the regional project, or it is the presence or the conscious construction of an identity that represents one specific region" *(Katzenstein, 1997).*

- Types of Economic Regionalism:
  - Monetary/Financial vs. Trade/Investment.
  - De facto vs. De jure.
  - Focus here is on de jure Monetary/Financial regionalism.

2. What is Asia?

- Pan Asian vs. Sub-regional.

- Various classifications:
  - 63 members of ADB.
  - 52 members of ESCAP (Asia-Pacific).
  - 21 members of Asian Cooperation Dialogue (ACD).

- *If membership is initially too broad initially it leads to a "convoy problem".*

- Smaller groups:
  - EMEAP (11 members).
    (*Australia, HK-SAR, Indonesia, Japan, Korea, Malaysia, NZ, PRC, Philippines, Singapore, Thailand*).
  - BIS-ACC (12 members).
    (*Australia, India, Indonesia, HK-SAR, Japan, Korea, Malaysia, NZ, PRC, Philippines, Singapore, Thailand*).
  - SEACEN (13 members).
    (*Indonesia,* Korea, *Malaysia,* Mongolia, *Myanmar, Nepal, Singapore, Sri Lanka, Thailand, Philippines, China, Taipei*).
  - ASEAN plus Three (APT)
    (*ASEAN-10, China, Japan, Korea*).
  - ASEAN plus Four (JACIK)
    (*APT plus India*).
  - ASEAN plus Six (APS).
    (*JACIK plus Australia and NZ*).

- If regionalism is too narrow and excludes large players looking to integrate with regional and global economy it may lead to defensive / reactionary strategies resulting in overlapping and untidy patchwork of sub regional “Asian alliances”.

- In a positive move, for the first time an explicit set of criteria was established for participation in first East Asian Summit (EAS) in Kuala Lumpur:

  - Full dialogue partner of ASEAN.
  - Substantive existing links with ASEAN.
  - Signatory to Treaty of Amity and Cooperation.

- Initial membership likely to be JACIK + ANZ or APS.

- Important to consistently include all these countries in future regional initiatives if they so desire.

3. Why Asia's Interest in MFR?

- External developments in regionalism, particularly deepening and broadening of European Union (EU).

- Financial crisis of 1997-98 and perceived inadequate response to it from extra regional players.

- Concerns about under-representation of Asia in IMF quota distribution and general lack of voice in international monetary affairs, as well as the belief that Asia has sufficient resources for regional self-help.

- Growing *de facto* economic interdependence and regional nature of spillovers ("contagion").

- Beyond the need for "sound" macro policies, *capital account nature of crises* has emphasized at least four things:

1) Importance of constant surveillance of policies (domestic and regional) and dynamics of financial markets.

2) Ensure availability of sufficient liquidity in the event of a bust.

3) Diversify sources of funding / channels of intermediation to minimize intensity of busts.

4) Minimize balance sheet mismatches.

4. Types of MFR in Asia

- Gradations of cooperation or policy initiatives.

  - *Weak form*: Policy dialogue, surveillance (*APT Economic Review and Policy Dialogue*), common early warnings signal (EWS), and monitoring of capital flows.

  - ***Medium form*: Development of regional liquidity arrangements and regional financial markets.**

  - *Strong form*: Exchange rate and monetary coordination and eventual monetary union.

5. Regional Liquidity Arrangements

- Chiang-Mai initiative (CMI). (*Initiated*).
- Reserve pooling arrangement. (*Proposed*).

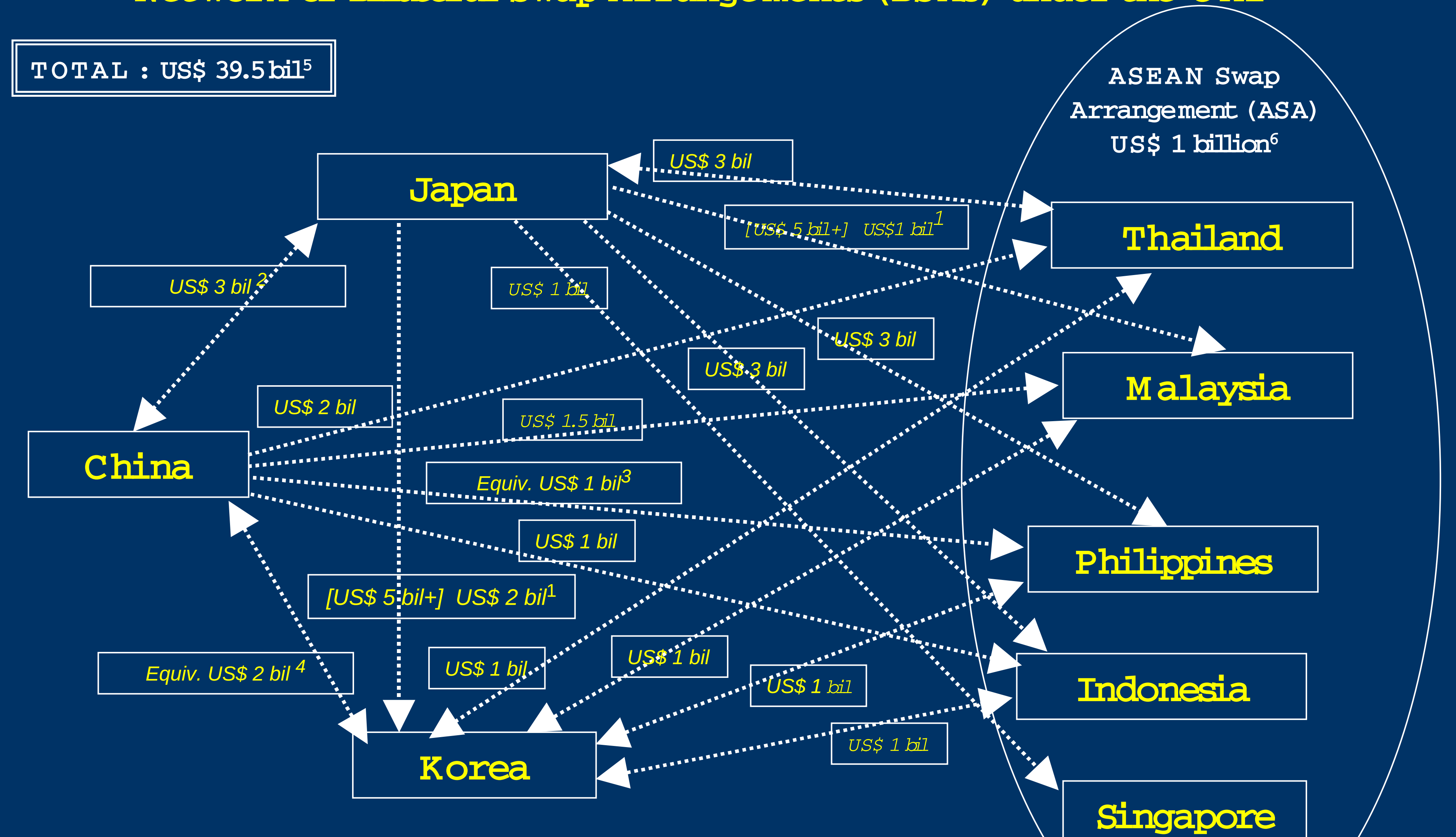
- CMI which is a network of swap arrangements was agreed among APT countries in May 2000.

- Aim of CMI is to provide countries under pressure with short-term hard currency liquidity and to supplement the existing international financial arrangements.

  - Important – CMI is not a fund for exchange rate stabilization!

- CMI has two components:
  - ASEAN swap arrangement (ASA) which was expanded from 5 to 10 countries, and from US$ 200 million to US$ 1 billion.
  - Networks of bilateral Swap arrangements (BSAs) among the three North Asian countries (Japan, China, Korea) and one of the three and one of the ASEAN countries.
  - A series of BSAs have been agreed upon with an aggregate size of over US$39.5 billion (16 arrangements).

Network of Bilateral Swap Arrangements (BSAs) under the CMI



1. The figure in brackets [ ] is the amount of BSAs reached under the New Miyazawa Initiative.
2. Local currency swap (between Japanese Yen and Chinese Yuan).
3. Local currency swap (between Chinese Yuan and Philippine Peso).
4. Local currency swap (between Chinese Yuan and Korean Won).
5. The US$39.5 bil includes the BSA between China and Thailand that is temporarily under expiry, but does not include BSA s reached under the new Miyazawa Initiative and the ASEAN Swap Arrangement (ASA)
6. It was agreed in April 2005 that the ASA would be increased to US$ 2bil and the details are under negotiation among ASEAN countries.

Source: Japan MOF

- Basic characteristics of the BSAs:
  - 10% (20%) can be drawn automatically without conditionality for 630 days (90 days, renewable 7 times).
  - Interest paid is LIBOR + 1.5% for first 180 days, rising by 50 basis points for each renewal to a maximum of LIBOR + 3%.
  - Swap providing countries form their own individual opinions on potential swap recipient.
  - Drawing of more than 10% (20%) requires country to come under IMF conditionality.

How Effective is the CMI?

- Size – US$ 40 billion versus US$ 140 billion package for Thailand, Indonesia and Korea.

- How is coordination to be done?

  - E.g. is bilateral arrangement subject to regional approval?

  - How is borrowing/lending to be distributed? – How to multilateralise it?

  - Limited duration of individual agreements.

Joint Ministerial Statement of 8th AFMM+3

Following measures to enhance the effectiveness of the CMI were agreed upon:

(I) "**Integration and enhancement of ASEAN+3 economic surveillance** into the CMI framework to enable early detection of irregularities and swift remedial policy actions, with a view to developing effective regional surveillance capabilities that complements the current undertaking by the International Financial Institutions (IFIs)."

(II) **"Clear-defining of the swap activation process and the adoption of a collective decision-making mechanism** of the current network of bilateral swap arrangements (BSA) as a first step of multilateralisation so that the relevant BSAs would be activated collectively and promptly in case of emergency".

(III) "**Significant increase in the size of swaps.** The size of the BSAs should be increased by:

(i) increasing the amount of existing bilateral commitment,
(ii) concluding new BSAs, for example, among ASEAN countries, and
(iii) transforming one-way BSAs to two-way BSAs.

Member countries favored an enhancement of up to 100% increase of the existing individual arrangements while noting that the size could be flexibly decided by bilateral negotiations. In this context, the ASEAN Swap Arrangement has been doubled from US$ 1 billion to US$ 2 billion."

(IV) "**Improving the drawdown mechanism.** The size of swaps that could be withdrawn without the IMF-supported program would be increased from the current 10% to 20% in order to better cope with sudden market irregularities while the current framework to complement the international financial arrangements and other disciplined conditions would be firmly maintained."

- In a nutshell:
  - CMI are to be doubled in size.
  - Unconditional liquidity share has been raised to 20%.
  - Bilateral swaps are being made two-way and further discussions on multilateralising the arrangements.
  - Collective mechanism to activate swaps. (this is critical — *e.g.. Indonesia*)
  - Recognition of need to improve on and link surveillance more to CMI.

6. Developments in Financial Cooperation in Asia

- Primary focus on the bond market.

- Two main initiatives:

  - Asian Bond Fund by EMEAP.

  - Asian Bond Market Initiative (ABMI) by APT.

  - Other initiatives at the APEC and ACD levels as well as private sector (Asian Bond Market forum).

- ABMI (August 2003) involves establishment of 6 working groups that examine various issues relating to the supply side of bond markets:

  - Securitization (Thailand).
  - Credit guarantees and investment mechanisms (Korea, China).
  - Settlement (Malaysia).
  - Issuance of local currency bonds (China).
  - Rating system (Singapore, Japan).
  - Information dissemination, technical assistance (Indonesia, Philippines, Malaysia).

- Details on http://asianbondsonline.adb.org

ABF 1 and 2

- ABF 1 (June 2003) — passively managed by the investment management unit of the Swiss-based BIS.

- Mandate is to invest in a basket of liquid US dollar sovereign and quasi-sovereign debt issued by 8 developing member economies (excluding Australia, Japan and New Zealand).

- ABF 2 (December 2004) — expanded in magnitude (US$ 2 bn) includes selected domestic currency sovereign and quasi-sovereign bonds in the 8 countries.

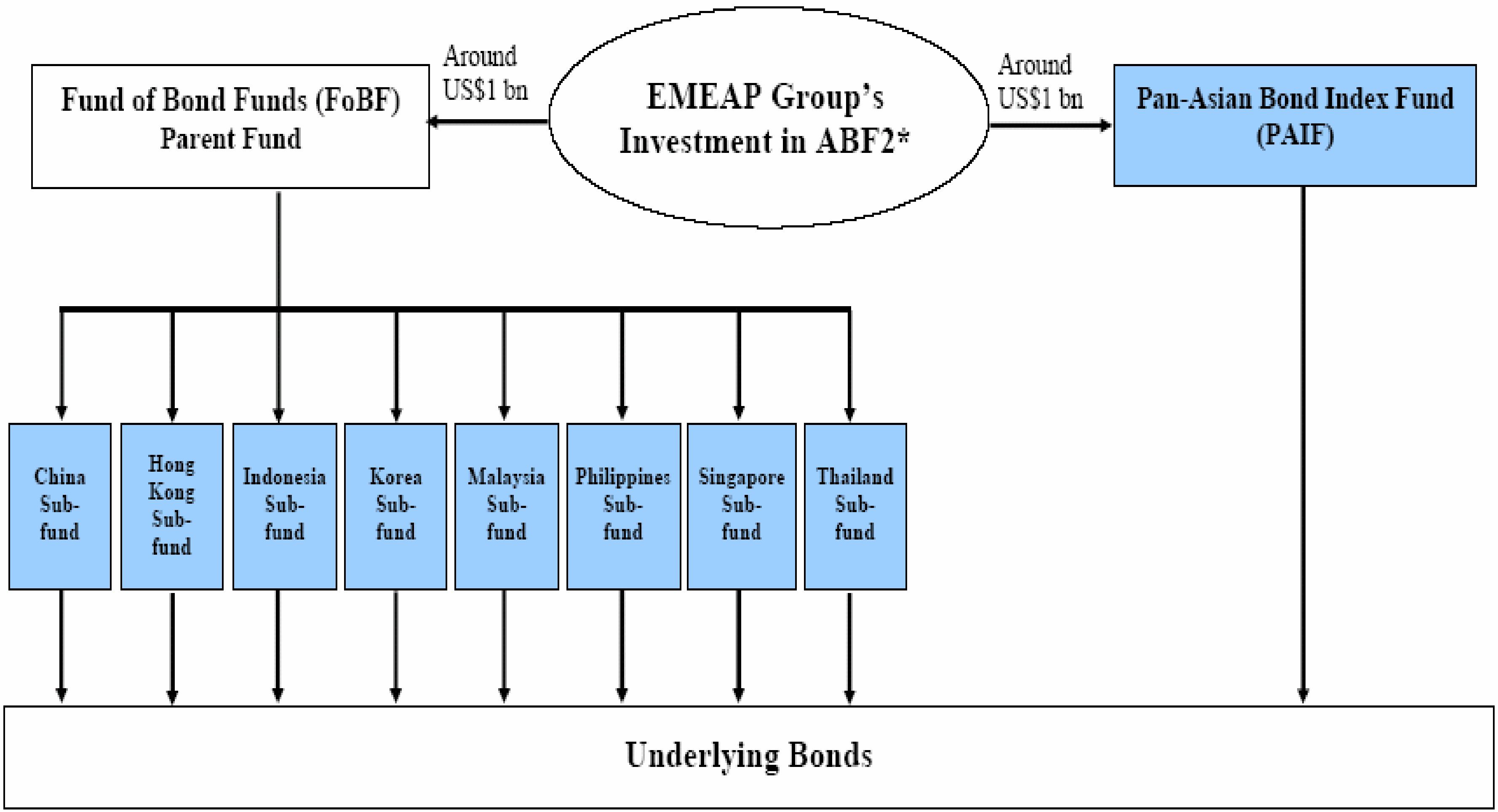
- ABF 2 comprises two components (US$ 1 bn each):

(1) A Pan-Asian Bond Index Fund (PAIF) — The PAIF is a single bond fund.

(2) A Fund of Bond Funds (FoBF) — The FoBF is a two-layered structure with a parent fund investing in eight single market sub-funds.

Annex I

ABF2 Framework



* The BIS will act as the Fund Administrator for EMEAP Group's investment in ABF2.

Components that will be open to investment by other public and private sector investors

- HSBC is the custodian of both funds.

- Benchmark indices for all 9 funds have been created by International Index Company, a joint venture between ABN Amro, JP Morgan and Morgan Stanley (iBoxx ABF).

- Funds will be passively managed to match the benchmark index.

- Seed money for single bond funds divided on *pre-determined criteria* and local fund managers appointed to manage the respective funds.

- Criteria for market weights in each sub-fund based on:
  - the size of the local market,
  - the turnover ratio in that market,
  - the sovereign credit rating, and
  - a market openness factor.
- Market weights will be reviewed annually, with market openness being a particularly important factor in the allocation of weights.

- Parent fund is limited to investments by EMEAP member central banks only.

- While initial phase of PAIF was confined to investment of EMEAP central banks only (US$ 1 bn) it was recently opened to investment by other retail investors in Phase 2.

- PAIF is domiciled in Singapore and initially listed on the HKSE (additional listings being considered) and managed by State Street Global Advisors (Singapore).

- Objectives of the ABF:
  - Develop regional financial / capital markets:
    - ✓ by reducing supply side constraints and introducing low cost products,
    - ✓ by raising investor awareness and broaden investor base on demand side).
  - Lead to a convergence in financial and capital market policies and accelerate improvements in financial market infrastructures.
  - Recycle regional funds intraregionally.
  - Reduce currency and maturity mismatches.

- Concerns with ABF:
  - If the supply of good quality sovereigns and quasi-sovereign paper is limited will it crowd out private investment?
  - If new supply of debt comes on stream, will it lead to excessive fiscal deficits?
  - Will it lead to premature capital market liberalization in some countries (*of concern given that weights dependent on openness*)?

7. Going Forward on MFR

Financial Regionalism

- Persist with attempts to develop well-functioning financial markets and institutions.

- Deepening and upgrading national and regional government and corporate bond markets as a means of reducing the region's heavy reliance on banks.

- ABF initiatives are modest steps in the right direction – expansion of size and membership.

- Discussions underway about creation of regional financial infrastructure (clearing and settlements systems, credit agency) as well as harmonization of withholding tax policies and capital account policies.

Joint Ministerial Statement of 8th AFMM+3

"We will continue and expedite our efforts in undertaking a wide variety of studies and implementing various effective measures under the ABMI working groups….(W)e will introduce a roadmap that proposes gathering and sharing information in an integrated manner on bond market development and on our related efforts with the regular self-assessment conducted by member countries. The possible issuance of Asian currency-basket bonds could be explored under the auspices of the roadmap. We also agreed to embark the study of Asian Bond Standards to explore the development of international bond markets in Asia through tailoring necessary infrastructure and setting the procedure entrusted by global issuers and investors."

- Recent suggestion floated about is for an Asia Basket Currency (ABC) Initiative:
  - Member countries issue local currency bonds.
  - The ABC corporation creates and issues basket currency bonds (weighted combination of regional currencies of the underlying national bonds) backed by regional sovereign bonds.
- If successful ABC it could provide a fillip for eventual creation of an Asian Currency Unit (ACU).

Monetary Regionalism: Weak form

- Enhancement of regional surveillance and dialogue:
  - Problems relating to membership.
  - Attitudes towards data transparency.
  - Peer pressure and sovereignty concerns (how evasive – e.g. exchange rate policies, behind-the-border issues like subsidies, etc.).

Monetary Regionalism: Medium form

- Enhancement of liquidity arrangements.

  - **Further augmentation of CMI:**

a) Expand size further and enlarge to include India (world's 5th largest reserve holder), Australia, NZ.

b) Multilateralise swap arrangement further.

c) Raise non IMF-linked share (what type of independent conditionality with teeth?).

d) Make transparent and automatic the condition for withdrawal.

- **Consider transforming CMI into a regional reserve pooling mechanism (ADB)?**

  Cost of reserve build-up — Opportunity costs (alternatives being proposed include reserve diversification and using funds for non-liquid purposes) and monetary sterilization costs.

Regional reserve pool:

- Owned reserves offer the highest degree of liquidity and have zero conditionality but are costly.
- Second tier: Sub-divided into country's own reserves placed with regional pool and other members' reserves with the pool.
- Third tier: Conventional IMF lending.
- With such a structure, the degree of liquidity could be inversely related to the degree of conditionality.

- But no forward movement until there is a considerable strengthening of the regional surveillance mechanism with well worked out policy conditionality.

Monetary Regionalism: Strong form

- 8th AFMM+3 endorsed further research on macroeconomic policy coordination. This is a prerequisite for greater exchange rate coordination.

- Types of exchange rate coordination:
  - ACU or Common basket.
  - Monetary integration / Common currency.

- Monetary integration could give rise to self-validating processes that facilitate trade and financial integration.

- However, deeper integration unlikely to occur dynamically following monetary integration.

- Political preconditions non-existent so forget about AMU or exchange rate coordination for now.

- Monetary and financial regionalism has thus far been a gradual process without a clear political goal in mind.

- Absent such a clearly articulated vision, deeper integrationst efforts (especially those in the monetary realm) are unlikely to anywhere anytime soon.

- Regionalism has been given a fillip by the newly established office in ADB.

Thank you!