

Prospects for Monetary Cooperation in Asia: ASEAN+3 and Beyond

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PRESENTATION

I. INTRODUCTION

**II. CURRENT STATES OF ASEAN+3
MONETARY COOPERATION**

**III. DEEPENING REGIONAL
ECONOMIC INTERDEPENDENCE**

**IV. PROSPECTS FOR FURTHER
MONETARY COOPERATION**

V. CONCLUDING REMARKS

I. INTRODUCTION

- Since the financial crisis of 1997-98, the East Asian economies have embarked on various initiatives for regional monetary and financial cooperation.
- These initiatives have included: ASEAN+3 Policy Dialogue and Economic Review; Chiang Mai Initiative; and Asian Bond Market Development.
- Efforts for crisis prevention, management and resolution are important drivers behind such initiatives.
- More fundamentally, rising economic interdependence within the region is a crucial factor.
- What are the key issues for further strengthening regional monetary/financial cooperation? Exchange rate policy coordination? Wider membership?

II. CURRENT STATES OF ASEAN+3 MONETARY COOPERATION

1. Chiang Mai Initiative (CMI)

- Early attempts:
 - (a) ASEAN Swap Arrangement (ASA)—Recently expanded
 - (b) AMF proposal (September 1997)—Aborted
 - (c) MFG Cooperative Financing Arrangement—2nd LOD
- CMI—Enhanced ASA combined with bilateral swap arrangements (BSAs) among the +3 countries and between the +3 and the core ASEAN
- 16 conceivable BSAs in place (Table 1)
- For more than 10%, CMI is linked to IMF programs
- CMI is under review in terms of the size, modality, IMF linkages, etc., starting in May 2004.

II. CURRENT STATES OF REGIONAL FINANCIAL COOPERATION (cont'd)

2. Policy Dialogue and Surveillance

- Early attempts (Table 2)
 - (a) ASEAN Surveillance Process
 - (b) Central bank process—EMEAP etc.
 - (c) Trans-regional processes—APEC, ASEM
 - (d) Manila Framework Group
- ASEAN+3 Economic Review and Policy Dialogue
- Surveillance (due diligence) vs. policy dialogue (information exchange, peer pressure)
- Need to ensure good due diligence and to make ASEAN+3 surveillance effective, like the G-7, WP-3 and OECD processes (EPC, EDRC).

II. CURRENT STATES OF REGIONAL FINANCIAL COOPERATION (cont'd)

3. Asian Bond Market Development

- Need to develop Asian currency-denominated bond markets to mobilize regional savings directly for regional investment, to make the financial system “more balanced” and avoid the “double mismatch” problem.
- Central bank process (EMEAP)—Asian Bond Fund-1 does not reduce the “double mismatch,” but ABF-2 will.
- ASEAN+3 process—local currency bonds.
- Need to create incentives for both investors and issuers, to establish national and regional market infrastructure for the secondary market of Asian currency-denominated bonds and to balance the risk of capital account opening.

III. DEEPENING ECONOMIC INTERDEPENDENCE

1. Trade and FDI Integration

- The region has embraced multilateral liberalization under GATT/WTO and open regionalism under APEC, and avoided discriminatory trade practices.
- The region has seen market-driven, *de facto* trade integration based on the trade-FDI nexus, with a focus on intra-industry trade
- A rising share of intra-regional trade in East Asia (Table 3a)
- High trade intensity in East Asia in comparison to NAFTA and EU (Table 3b)

III. DEEPENING ECONOMIC INTERDEPENDENCE (cont'd)

2. Formation of Regional EPAs/FTAs

- The region, including Northeast Asia, has recently shifted to a three-track approach to trade and FDI liberalization: global (WTO) cum trans-regional (APEC), regional (ASEAN+3), and bilateral.
- AFTA has been a relative success.
- Japan-Singapore EPA, and many negotiations are underway: Japan-Korea, China-ASEAN, Japan-Malaysia, Japan-Thailand, Japan-Philippines, etc.
- Need to avoid the "spaghetti bowl" effect and to ensure WTO consistency by making EPAs/FTAs a building block for global liberalization.

III. DEEPENING ECONOMIC INTERDEPENDENCE (cont'd)

3. Financial Integration

- Regional financial integration due to financial sector deregulation and capital account liberalization—through syndicated loans, equities and bonds.
- There are relatively strong co-movements of real financial variables within East Asia (Table 4).
- Contagion of currency crises in 1997-98.
- China still maintains capital controls but they are gradually eroded as observed in the recent rise of errors and omissions in the BOP.

III. DEEPENING ECONOMIC INTERDEPENDENCE (cont'd)

4. Macroeconomic Interdependence

- Patterns of macroeconomic interdependence (Table 5)
 - (a) Japan and Korea have large positive co-movements of real economic activity with each other and with emerging East Asia (EEA), including Korea and ASEAN
 - (b) ASEAN has large co-movements among themselves.
 - (c) China has no positive correlation with East Asia (EA).
 - (d) US has no positive correlation with EA.
- As China completes economic transition through reforms, liberalization, and market opening, its macroeconomic synchronization with East Asia is expected to rise.
- The next group is India, Australia and New Zealand.

IV. PROSPECTS FOR FURTHER MONETARY COOPERATION

1. Effective ASEAN+3 Surveillance

- Nurture mutual trust and develop a good surveillance culture.
- Involve central bank governors in the ASEAN+3 process—ownership by central banks
- Establish an ASEAN+3 Secretariat for effective surveillance and financing—technically competent staff, dedicated to the ASEAN+3 process, to provide objective economic analysis, and to assist liquidity financing with appropriate conditionality.
- Invite the IFIs and the private sector

IV. PROSPECTS FOR FURTHER MONETARY COOPERATION (cont'd)

2. CMI Review and Going beyond the CMI

- CMI review
 - (a) Enlargement of its size due to limited amounts on a bilateral basis
 - (b) Multilateralization to enhance effectiveness and relax the size constraint
 - (c) Reduction of IMF linkages requires effective surveillance
 - (d) Greater use of Asian currencies, particularly the yen
- Going beyond the CMI
 - (a) Pooling of reserves
 - (b) Medium-term financing facility (a la IMF stand-by)
 - (c) Transforming the ASEAN+3 Secretariat into an international organization to help support financing
- Establishing a full-fledged AMF in the near future.

IV. PROSPECTS FOR FURTHER MONETARY COOPERATION (cont'd)

3. Exchange Rate Policy Coordination

- Exchange rate issues should be part of the enhanced surveillance process, to avoid intra-regional currency misalignment and competitive de-(and re-)valuations.
- Creating a regional common unit of account—Asian Monetary Unit of Account (AMU)
- A G-3 currency basket system as a transition arrangement for emerging East Asia, and a float for Japan.
- After sufficient economic convergence and institution building, the East Asian economies that are ready can move to an Asian Snake.

IV. PROSPECTS FOR FURTHER MONETARY COOPERATION (cont'd)

4. Deepening and Expansion of ASEAN+3

- A long-term vision, such as the formation of an East Asian economic and monetary union (EMU), and political commitments are needed to deepen integration.
- To further nurture this trend, *de facto* economic integration must proceed, and institutional formalization of *de facto* integration will be needed.
- Once sufficient deepening is achieved, ASEAN+3 may be expanded to include India, Australia, and New Zealand if they so wish.

V. CONCLUDING REMARKS

- East Asian economies have been deepening real, financial and macroeconomic interdependence over the last two decades, providing a fundamental rationale for monetary and financial cooperation.
- They have focused on three pillars of regional monetary and financial cooperation:
 - (a) Regional liquidity provision through the CMI;
 - (b) Surveillance through the ASEAN+3 PDER process;
 - (c) Asian bond market initiative
- Exchange rate policy coordination has yet to begin
- A long-term vision, such as the formation of an East Asian economic and monetary union (EMU), and political commitments are crucial.

V. CONCLUDING REMARKS (cont'd)

- East Asia can deepen monetary/financial policy coordination in three stages, i.e., loose, tight and complete, on a multi-track basis.
- Before moving to the second stage, each economy must strengthen domestic policies and institutions.
- Real side institutional formalization of *de facto* economic integration is key, starting with a region-wide FTA, then a customs union and a common market.
- Immediate policy priorities include: effective ASEAN+3 surveillance; stronger CMI; bond market development; and initiation of loose exchange rate policy coordination.
- Expand membership to include India and Australia once sufficient deepening of ASEAN+3 is achieved.