

Regional financial cooperation in Asia: challenges and path to development

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I. Introduction

Since the late 1990s, when the financial and foreign exchange crisis broke out, financial cooperation within the Asian region has centred on regional financial forums. These endeavours have achieved considerable results, although somewhat slowly. These results include the setting up of regional liquidity support arrangements through the Chiang Mai Initiative (CMI), the establishment of the Asian Bond Fund (ABF), and the progress of the Asian Bond Market Initiative (ABMI). These accomplishments have been largely the work of various regional financial forums, especially the Association of Southeast Asian Nations Plus Three (ASEAN + 3) and the Executive Meeting of East Asia-Pacific Central Banks (EMEAP). Moreover, all initiatives for financial cooperation are being undertaken at a time when Asian countries, especially China, Japan and Korea, have already accumulated experience in regional financial cooperation. Therefore, to some extent the foundation needed to continue these cooperation efforts is already in place.

Meanwhile, there has been an increasing number of financial forums on regional financial cooperation, and the range of their discussions has also been broadened. Selection and concentration of topics related to cooperation is therefore required. A gap has also been exposed between the expectations and the reality of regional financial cooperation, as well as the expectations of growing visible accomplishments. Using our empirical knowledge, therefore, we need to examine what challenges must be overcome in order to achieve efficient regional financial cooperation. It is also important that we determine the direction we should take in improving our regional financial cooperative system.

II. Progress of Asian regional financial cooperation

1. Background of Asian regional financial cooperation

The Asian financial crisis in 1997 provided a direct impetus for countries to recognise the need for regional financial cooperation. Having experienced the financial crisis, Asian countries reached a consensus on the need to enhance their own risk management abilities in order to prevent and resolve any future financial crises. They needed to do so by strengthening regional financial cooperation, instead of depending merely upon support from international financial organisations, including the International Monetary Fund (IMF), and from advanced countries. The strengthening of regionalism around the world, with the launch of the European Economic and Monetary Union (EMU) (and the euro) in 1999, and the advancement of economic integration in the Americas, has also led Asian countries to participate actively in regional financial cooperation with a view to protecting the region's interests and boosting its status in the international community.

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As a result, Asian countries have, since the 1997 crisis, started to engage in active discussions of regional financial cooperation. In their efforts to come up with means of preventing and effectively coping with financial crises in the region, the countries have achieved visible results, including the setting up of a regional emergency liquidity provision regime. The financial crisis was attributable mainly to regional countries' increasing dependence upon foreign capital and bank loans, owing to their relatively underdeveloped financial markets. It was due as well to the maturity mismatches in overseas markets, such as long-term lending and short-term borrowing. In recognition of this fact, countries have focused on ways of developing regional financial markets, for example, by fostering regional bond markets.

2. Outline of regional financial cooperation bodies

Financial cooperation in the Asian region is currently being led by ASEAN + 3 and the EMEAP, in addition to many other cooperation bodies and organisations, including ASEAN, Asia-Pacific Economic Cooperation (APEC), the Asia-Europe Meeting (ASEM), the South East Asian Central Banks (SEACEN) Research and Training Centre, and the SEANZA (Southeast Asia, New Zealand and Australia) countries (Table 1).

First of all, ASEAN + 3 and the EMEAP play central roles in the current regional financial cooperation projects. In ASEAN + 3, countries have established a regime of regional emergency liquidity provision through bilateral swap arrangements (BSAs) under the CMI. They have also sought to develop regional bond markets through the ABMI. In ASEAN, which comprises the 10 Southeast Asian countries, coordination of views and agreement among members based upon close cooperation since the 1960s have also contributed to the smooth promotion of the ASEAN + 3 financial cooperation projects. In the EMEAP, the cooperative organisation of regional central banks, members have set up and operated the ABF as a way of fostering regional bond markets. They recently also established a Monetary Financial Stability Committee (MFSC) to strengthen financial and economic monitoring and risk management in the region.

Unlike ASEAN + 3 and the EMEAP, the region's other cooperation bodies have not engaged in concrete cooperation projects. Rather, they have carried out limited research on regional cooperation-related themes and have shared information through annual meetings and irregularly scheduled workshops. The East Asia Summit (EAS), comprising the ASEAN + 3 members, Australia, India and New Zealand, has been seeking ways of strengthening regional economic cooperation among its members, with the help of the ASEAN Secretariat. SEANZA and SEACEN, regional financial cooperation organisations of central banks, have focused on training and research activities to enhance member central bankers' capacities.

APEC and the ASEM, in which countries from the Americas and Europe also participate, have pursued financial cooperation in a limited range. The APEC Finance Ministers' Meeting has been working on projects to strengthen regional financial cooperation, increase provision of technical support, and develop a regional bond market. In particular, the Asia-Pacific Finance and Development Centre in China has led the APEC Finance and Development Program. The ASEM, whose objective is to strengthen economic cooperation between Asia and Europe, has also established the ASEM Trust Fund in its Finance Ministers' Meeting. Recent financial cooperation projects include the operation of systems of cooperation among member countries in times of economic and environmental emergencies, such as financial crises or, for example, tsunamis.

Table 1

Regional monetary and financial forums

Forum¹	No of members	Member countries
Central bank cooperation		
EMEAP (1991)	11	Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand
SEACEN (1966)	16	Brunei, Cambodia, Fiji, Indonesia, Korea, Malaysia, Mongolia, Myanmar, Nepal, Papua New Guinea, the Philippines, Singapore, Sri Lanka, Taiwan, Thailand, Vietnam
SEANZA (1956)	20	Australia, Bangladesh, China, Hong Kong SAR, India, Indonesia, Iran, Japan, Korea, Macau, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Papua New Guinea, the Philippines, Singapore, Sri Lanka, Thailand
Finance ministry-led		
ASEAN (1967) ²	10	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam
ASEAN + 3 (1999)	13	10 ASEAN countries, China, Japan, Korea
APEC (1994)	21	Australia, Brunei, Canada, Chile, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Taiwan, Thailand, the United States, Vietnam
ASEM (1997)	43	27 EU countries, ASEAN + 3, India, Mongolia, Pakistan
Others		
EAS (2005)	16	ASEAN + 3, Australia, India, New Zealand
ACD (2002)	30	ASEAN + 3, Bahrain, Bangladesh, Bhutan, India, Iran, Kazakhstan, Kuwait, Mongolia, Oman, Pakistan, Qatar, Russia, Saudi Arabia, Sri Lanka, Tajikistan, United Arab Emirates, Uzbekistan

¹ Figures in parentheses are years of foundation. ² AFMM and ACBF started after 1997.

3. Regional financial cooperation agenda

Regional financial cooperation can be subdivided into three categories. These are strengthening crisis management regimes, developing a regional bond market, and studying regional exchange rate cooperation and monetary integration.

A. Strengthening crisis management regimes

Since the financial crisis in the late 1990s, Asian countries have made joint efforts to create cooperative schemes for resolving and preventing any future crises. They have focused on two pillars – establishing a regional financing arrangement, and strengthening the surveillance and monitoring framework. Measures to establish a regional financing arrangement include the conclusion of bilateral swap arrangements (BSAs) under the ASEAN + 3 CMI. As the financing network of BSAs among regional countries has been successfully established, members are discussing multilateralisation of the CMI to set up a more advanced regional liquidity provision framework based upon it. The strengthening of

regional surveillance and monitoring regimes has been dealt with as a major challenge in both ASEAN + 3 and the EMEAP.

(Establishment of a regional financing arrangement)

The CMI, adopted at the ASEAN + 3 Finance Ministers' Meeting in May 2000, established a network of BSAs under which, in times of financial crisis, member central banks provide liquidity to their counterparts up to certain agreed-upon amounts. Under the CMI, China, Japan and Korea have concluded BSAs with one another, and also with five ASEAN countries. The ASEAN countries have expanded the volumes of the existing swap arrangements, which had been maintained since 1977, instead of concluding separate bilateral arrangements with one another.² As of December 2007, the number of BSAs reached 17, with the total funding volume amounting to \$84 billion.

The ASEAN + 3 countries have made great efforts to develop the BSAs of the CMI into a more efficient regional financing framework (Table 2). Members agreed to double the amounts of their BSA funding support in 2005. In 2006, they increased the effectiveness of the financing framework by introducing a collective decision-making process, in which financing countries are called upon within two days after the outbreak of a crisis, and fully provide the support required after deciding upon financing within one week.

Table 2

Schedule and major agenda items for CMI multilateralisation discussion

	Schedule	Major items
Stage 1	Completed (~ 2007.5.5)	Basic items for CMI multilateralisation: ① Means of participation ② Legal forms ③ Surveillance framework
Stage 2	2007.5.6 ~ Ministers' Meeting in 2008	Core items for CMI multilateralisation: ① Size of funds and additional financing ② Quotas for borrowing and lending (borrowing) conditions ③ Financing mechanism
Stage 3	Ministers' Meeting in 2008 ~	Detailed implementation plan

Most notably, in the May 2006 ASEAN + 3 Finance Ministers' Meeting, member countries agreed to initiate discussions on developing the framework into a more advanced one (in a process designated as CMI multilateralisation or post-CMI). Members subsequently completed the first stage of discussions in May 2007, by deciding to pool their reserves

² ASEAN adopted a \$200 million ASEAN Swap Arrangement (ASA) in August 1977 to promote regional monetary cooperation among the central banks of five ASEAN members: Indonesia, Malaysia, the Philippines, Singapore and Thailand. In May 2000, it expanded the number of ASA participants from five to 10 countries, and the amount from \$200 million to \$1 billion. The amount was further expanded to \$2 billion in April 2005.

through a self-managed reserve pooling arrangement under a contractual agreement, and to strengthen their surveillance of financial and economic trends through the ASEAN + 3 Economic Review and Policy Dialogue (ERPD). In the second half of 2007, countries held working-level discussions on concrete plans for multilateralisation of the current BSAs, including financing methods. In particular, at the ASEAN + 3 Finance and Central Bank Deputies' Meeting held in Lijiang, China, in late November 2007, members discussed the volume of the multilateralised CMI fund, borrowing quotas by groups, and details including payment methods and borrowing conditions.

Other regional financing frameworks established after the 1997 crisis include the New Miyazawa Initiative (NMI), proposed by Japan in 1998, the ASEM Trust Fund (ATF, or Asian Financial Crisis Response Fund) established by the ASEM based upon a proposal by the United Kingdom, and a system of US Treasury bond repo agreements among EMEAP countries. Japan concluded several individual financing arrangements with regional countries based upon the NMI. Only a \$2.5 billion swap arrangement with Malaysia remains in place currently, as the other arrangements have either reached maturity or been cancelled prior to maturity. The ATF was designed to provide technical assistance related to financial restructuring in countries hit by the Asian financial crisis. The fund amounts to a total of \$800 million, and has been provided to regional countries.³ The system of US Treasury bond repo agreements among EMEAP members was started in November 1995 to establish a framework for cooperation among central banks and ensure regional foreign exchange market stability. The amount of the agreement was expanded after the 1997 financial crisis, but it has never been implemented so far.⁴

(Reinforcement of surveillance and monitoring system)

For independent and efficient operation of the regional funding system in times of financial crisis, it is essential that conference bodies build their own surveillance and monitoring systems so they can observe financial and economic developments in each regional member country. In the current CMI-BSA system, 80% of the amount agreed for funding is linked to the IMF's decision, which greatly limits the independence of the funding operation.⁵ This is because, unlike the IMF, the CMI lacks independent and credible surveillance and monitoring.

Accordingly, countries in the region have made efforts to build systems for surveillance and monitoring of regional financial and economic developments and to strengthen their policy cooperation through these systems. The Manila Framework was launched in 1998, in the aftermath of the 1997 financial and foreign exchange crisis, with the goal of strengthening financial stability in the Asian region. As one of its major projects, it began building a surveillance mechanism in the region to complement the IMF's global surveillance. Although it had lasted for six years, the Manila Framework was terminated at its 12th meeting in November 2003, without having achieved any concrete results.

Since April 2002, ASEAN + 3 has examined regional economic and financial developments through its ERPD and sought means of policy cooperation. However, the ERPD, which

³ Nine European countries and China raised \$45 million to form ATF I (1998–2002) and supported seven Asian countries. ATF II was created by eight European countries, China and Korea. It totalled \$35 million, and was provided to five Asian countries.

⁴ Under the repo agreements, countries have been able to provide financial support in US dollars, with US Treasury bonds as collateral, during a very short period. Therefore, the agreements have not been so useful as a crisis resolution measure.

⁵ Funding through the CMI-BSA is mostly limited to cases where IMF programmes/funding have already been executed or will soon be executed. However, for up to 20% of the contracted amount, funding can be provided at the donor's discretion, without linkage to an IMF programme.

remains merely a means of examining country-specific macroeconomic indicators, has no surveillance functions and cannot demand any actions from member countries. The ERPD is thus inadequate as a regional economic surveillance system. In May 2006, therefore, the Technical Working Group on Economic and Financial Monitoring (ETWG) and the Group of Experts (GOE) were created. These groups support member countries in building policy collaboration through regular monitoring of economic and financial developments, and at the same time enhance their crisis management capabilities by facilitating early detection of crisis symptoms. During the Finance Ministers' Meeting in May 2007 in Kyoto, Japan, the ministers agreed to tighten the connections among the ERPD, ETWG and GOE, to further promote their functions of surveillance of regional economic and financial developments.

The EMEAP is also working on building a system for regional monetary and financial monitoring. In April 2007, the Monetary and Financial Stability Committee (MFSC), composed of deputy governor-level staff of member central banks, was launched. This committee handles regional monetary and financial monitoring, and also performs such activities as risk and crisis management and resolution. In May 2007, the MFSC decided to launch a regional monetary and financial monitoring system.⁶ Then, in November 2007, its members agreed to build a regional crisis management and resolution network.⁷

After the financial crisis, ASEAN members designed the ASEAN Surveillance Process (ASP), and have drawn up monitoring reports on members' and regional economic developments with help from the ASEAN Finance and Central Bank Deputies' Meeting, the surveillance and coordination body of the ASEAN Secretariat, the Asian Development Bank (ADB), etc. This ASEAN surveillance report includes policy recommendations concerning regional financial and economic developments. The finance ministers of the ASEAN member countries exchange opinions and information through peer reviews, and discuss measures needed to cope with potential risk factors in order to enable members to be prepared for emergencies.

B. Development of regional bond markets

Since the Asian financial crisis, there have been active discussions in most regional financial forums regarding the development of Asia's financial markets, which had been relatively backward. There has been remarkable progress, especially in discussions concerning the development of regional bond markets, particularly during EMEAP and ASEAN + 3 meetings, aimed at lessening dependence on funding from outside the region and cultivation of funding from within the region.

The EMEAP has created the ABF, a fund comprising foreign exchange reserves held by regional member central banks. Its investment in regional bonds is contributing to the development of regional bond markets. ASEAN + 3 is seeking ways to spur issuance of bonds within the region and member countries through the ABMI, and to build a common substructure (a credit guarantee, credit rating and settlement system) that can foster regional bond market development. APEC is also searching for ways to strengthen member countries' capacities to develop their regional financial markets, including bond markets, through discussions on how to promote securitisation and credit guarantee markets.

⁶ This monitoring system comprises the following: macro-monitoring done by dedicated resources from each member central bank; monitoring performed by the three working groups in their respective fields; and the Dealing Room Network, connecting the network of the IFIs (eg, the IMF and the BIS) and the EMEAP member central banks.

⁷ The crisis management network is composed of the High-level Team and the Technical-level Crisis Management Team (CTM). The High-level Team advises members on policy alternatives in dealing with crises, and also provides them with a point of contact with the IFIs. The CTM supports the High-level Team through data collection and execution of business continuity plans (BCPs) in times of crisis.

(Creation of the Asian Bond Fund)

The EMEAP has created bond-type funds, invested in jointly by member countries, to boost regional bond markets and diversify the investment targets of members' foreign exchange reserves. As a result, the ABF-1 and ABF-2 were launched in July 2003 and April 2005, respectively, and have been in operation ever since.

The ABF-1 is a bond-type fund with a total size of \$1 billion. Its investments are limited to US dollar-denominated bonds issued by EMEAP member governments (except Japan, Australia and New Zealand) and governmental institutions.

The ABF-2 is composed of the Pan-Asian Bond Index Fund (PAIF) and the eight Single-market Funds. Its investment targets are bonds issued by the governments and government institutions of eight EMEAP member countries (China, Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand) and denominated in their local currencies.⁸ Australia, Japan and New Zealand, whose bond markets are already advanced, are excluded. The ABF-2 started out as a \$2 billion bond-type fund created with foreign exchange reserves of EMEAP members. However, through listing and public offerings, it now also attracts private funds.

(Discussions regarding regional bond market development)

Remarkable progress has been made in discussions of ways to foster regional bond markets. The ASEAN + 3 ABMI has organised working groups dedicated to work in various relevant fields (Table 3).

Table 3

Activities of ABMI working groups

Working groups	Activities
New Securitised Debt Instruments	Finding ways to provide tax incentives for regional currency-denominated bond transactions to promote efficient supply of these bonds, ways to issue ABSs, and ways of coordinating a response to withholding taxation
Credit Guarantee and Investment Mechanisms	Discussing ways to establish a single credit guarantee and investment institution to facilitate more active issuance of regional bonds
Foreign Exchange Transactions and Settlement Issues	Studying ways to improve the regional payment/settlement system; organising a group of experts to study establishment of a regional depository organisation
Rating Systems and Information Dissemination on Asian Bond Markets	Studying ways to improve the regional credit rating system and reinforce the credit information dissemination system
Technical Assistance (TA) Coordination Team for the Focal Group	TA for globalisation of members' bond markets and for improvement of human resource quality in these markets

⁸ The PAIF is a unified fund that invests in local currency-denominated sovereign and quasi-sovereign bonds of eight EMEAP bond markets. The eight Single-market Funds are country funds that invest in the same bonds of the respective markets.

The Working Group on New Securitised Debt Instruments is devoted to finding ways for issuance of bonds to finance infrastructure, for securitisation of loans and charge sales bonds, and for issuance of regional medium-term notes (MTNs). The Working Group on Credit Guarantee and Investment Mechanisms has confirmed (November 2007) that a regional credit guarantee and investment organisation will be established, in the form of a fund operated under the ADB, and it is now working on detailed plans for its implementation. The Working Group on Foreign Exchange Transactions and Settlement Issues has discussed how regional foreign exchange settlement risks can be minimised, although not much progress has been achieved due to conflicts of interest among members. Finally, the Working Group on Rating Systems plans to come up with ways to improve the comparability and level of standardisation of regional credit rating agencies, and boost their functions by May 2008. Its aim is to enhance the credibility and transparency of regional credit rating agencies.

APEC members have continued discussing the cultivation of regional bond markets for the past 10 years. They have launched several initiatives, namely: the Initiative on Securitisation Promotion (1997–98), launched in April 1997; the Initiative on Regional Bond Market Development (1998–99), launched in May 1998; and the Initiative on Development of Securitisation and Credit Guarantee Markets (2002–04), launched in September 2002. It has been recognised that one of the elements undermining the development of regional bond markets is the credit quality gap – ie, regional issuers' credit rating levels do not meet investors' expectations. In line with this awareness, APEC has tried to find ways of encouraging more active credit guarantees and securitisation. Even until recently, APEC has tried to strengthen regional members' capabilities in developing their financial markets, through initiatives such as the AFDP (APEC Financial Development Program), the APEC Public-Private Dialogue on Bond Market Development, and the Initiative on Strengthening Capital Markets in the APEC Region.

C. *Studies on regional foreign exchange cooperation and regional monetary integration*

The basic goal of regional financial cooperation since the financial crisis has been to build an emergency funding system in preparation for possible future financial crises. At the same time, however, studies have also been done continually on how major regional countries can cooperate in their foreign exchange-related policies and unify their currencies. These studies have been conducted based on a mid- to long-term perspective, with the aim of, eg, preventing competitive devaluations of currencies in times of foreign exchange crisis.

Recently, systematic studies have been conducted by regional development financial organisations (eg, the ADB) and conference bodies (eg, ASEAN + 3), based on academic studies carried out by major research institutes. The ADB has been conducting research on development of an Asian Currency Unit (ACU) since 2005.⁹ During the China-Japan-Korea Finance Ministers' Meeting in May 2006, the participants agreed that the three governments together would initiate research on an Asian common currency basket. ASEAN + 3 has been studying the development of a single regional monetary unit since 2006. In the ASEAN + 3 Research Group, led by a private research institute, Japanese researchers have since 2006

⁹ The ACU would be a weighted average index of an Asian regional monetary basket. It would be an indicator used to monitor the movements of regional currencies as a whole against currencies outside the region (eg, the US dollar and the euro) and against the currencies of individual regional countries.

been studying the adoption of a regional monetary unit (RMU) in Asia, by considering the European Union's adoption of the EMU.¹⁰

The ASEAN Central Bank Forum (ACBF) has also, since 2000, been studying the prospects for adopting a single monetary and foreign exchange system for the ASEAN region. In 2000, the Forum organised a task force team to conduct research on the feasibility of a single monetary and foreign exchange system in the ASEAN region. In 2007, it set up a new task force team to conduct research on the foreign exchange system in the ASEAN region.¹¹

III. Challenges to the strengthening of regional financial cooperation

The foundation for setting up a regional financial cooperation framework seems to have been laid, as Asian countries have pursued financial cooperation for a decade since the 1997 financial crisis. In order for this framework to develop more and produce substantial results in the future, however, the following challenges must be overcome.

1. Creating synergy through division of work among major regional financial forums

(Problems resulting from diverse cooperation channels and leading institutions)

The channels of regional financial cooperation have become very diverse, as Asian financial cooperation has been conducted through a variety of forums that are different from one another in terms of their structures and the natures of the institutions leading them. Concerning the structures of these forums, ASEAN has 10 Southeast Asian countries as its members, while APEC and the ASEM have 21 and 43 members, respectively, including countries from outside the Asian region. ASEAN + 3, APEC and the ASEM are government-led (central banks might participate depending upon the areas of cooperation), while the EMEAP, SEACEN and SEANZA are forums of central banks. SEACEN and SEANZA focus mainly on providing training programmes to enhance the capacities of member central bankers.

As multiple forums conduct discussions on similar themes in similar areas due to the existence of such diverse channels, human and physical inefficiencies might arise (Table 4). In particular, as the EMEAP has focused more on regional financial cooperation since 2007, its agenda overlaps greatly with that of the government-led ASEAN + 3.¹²

(Creating synergy by enhancing connections between consultative channels)

Tasks should be reorganised in consideration of the expertise and driving forces of the different regional forums, while the connections between the forums should be increased, so that they can refer to and utilise the results of each other's discussions for each task. More specifically, for example, synergy can be created if the government-led ASEAN + 3 establishes a financing regime for coping with a regional financial crisis, while the central bank-led EMEAP strengthens its surveillance and monitoring functions. It has also been argued that some of the

¹⁰ Japan has categorised its research in line with four objectives: first, a currency composition plan for the RMU, in accordance with the purposes of its adoption; second, a plan for using the RMU to stabilise regional foreign exchange rates; third, a plan for encouraging use of the RMU in regional financial markets; and fourth, a roadmap for RMU adoption.

¹¹ The task force team has concluded in its research that it is still premature to adopt a single monetary and foreign exchange system in the region, since it remains difficult for the macroeconomies of all ASEAN countries to converge under such a system.

¹² For example, both ASEAN + 3 and EMEAP have promoted stronger surveillance and monitoring in the region.

forums need to be developed into permanent organisations, or even further into international financial institutions that wield political and economic binding force supranationally.

Table 4

Financial cooperation agenda of regional forums

	APEC	ASEAN	ASEAN + 3	ASEM	EMEAP	SEACEN	SEANZA
Liquidity support		√	√				
Surveillance/ monitoring		√	√		√		
Financial market development	√	√	√	√	√		
Monetary integration		√	√				
Capacity building	√	√	√	√	√	√	√

Most forums other than ASEAN and SEACEN, which have their own secretariats or permanent administrative offices, lack permanent organisations in charge of implementing and coordinating their cooperative projects and contacting their members (Table 5). They therefore depend upon the experiences of certain member countries (or the rotating chair countries) or other international organisations such as the ADB and the BIS. If they continue to depend upon certain specific members or international financial organisations, they will face limitations in achieving regional cooperation results and developing their own capacities through establishment of regional financial cooperation regimes.

It is not easy in reality for member countries to reach consensus on resolving this problem, owing to various factors including the additional expense of establishing secretariats, and possible conflicts of interest among members. In the medium and long run, however, they need to come up with practical measures to increase their activities and the effectiveness of their functions in the region, including planning to set up permanent offices.

Table 5

Organisations supporting regional financial forums

Forum	Organisations
SEACEN	Enhance capacity of central banks in the region through the SEACEN CENTRE
EMEAP	No secretariat. Depends upon capacities of the BIS and individual members, including Hong Kong SAR and Singapore, for its major initiatives such as the ABF
ASEAN	ASEAN Secretariat
APEC, ASEM, ACD, EAS, SEANZA	No secretariat. Depend upon other international organisations, including the World Bank (ASEM Trust Fund), ASEAN Secretariat (EAS), and ADB
ASEAN + 3	No secretariat. Depends upon indirect assistance from other international organisations, including the ASEAN Secretariat and ADB for the CMI and ABMI

2. Establishing surveillance and monitoring frameworks

Some regional forums, including ASEAN + 3 and the EMEAP, have worked on establishing regional surveillance and monitoring frameworks, but the current monitoring has not developed beyond an initial stage of peer review of economic conditions of member countries and their major statistical indices. Owing to its underdeveloped monitoring function, financing through the BSAs under the CMI of ASEAN + 3 has relied greatly upon surveillance and monitoring by the IMF, with 80% of its financing linked to the IMF's financing decisions. The increasing dependence of regional forums upon international organisations outside the region for their surveillance and policymaking decisions may undermine their abilities to respond rapidly and effectively to financial crises in the region.¹³

To increase the effectiveness of the multilateralised financing framework of the ASEAN + 3 CMI and prevent moral hazard in recipient countries in times of crisis, regional forums need to set up their own surveillance and monitoring frameworks that are more systematic and binding. The EMEAP's Monetary and Financial Stability Committee is working to ensure more rapid information exchanges and decision-making by establishing a working-level risk management system. In view of this, ASEAN + 3 also needs to increase the linkages between surveillance activities and financing in its CMI multilateralisation efforts, so that it can provide actual financing in times of crisis.

3. Strengthening cooperation with major international financial organisations

Regional cooperative forums need to strengthen their cooperative relationship with major international financial organisations. This will help to ensure that the region's common interest is reflected properly in the international community and enable the promotion of regional financial cooperation to proceed more smoothly. For example, when Japan proposed establishing an Asian Monetary Fund (AMF) in the wake of the 1997 Asian financial crisis, this could not be realised owing to opposition from the United States, which was concerned about weakening the IMF's role. The current financing system of the CMI-BSA is also in a complementary relationship to the existing international financial organisations, such as the IMF.

If the current CMI multilateralisation discussion on setting up a regional financing framework develops further, so as to deal also with the possible establishment of a regional financial organisation, support from the existing international financial organisations, including the IMF and the ADB, is essential. In this case, the cooperative relationships between regional forums and international organisations would become closer, and regional forums would also build a more cooperative relationship with one another, with each forum specialising in different areas, for example.

In promoting their cooperative projects, these regional forums also need to utilise the knowledge and experience of the existing international financial organisations, including the IMF, the BIS, and the ADB. For instance, the EMEAP, which has already successfully established the ABF in cooperation with the BIS, can fully utilise the experiences of the BIS when developing measures to foster regional bond markets. Technical advice from the IMF, based upon its diverse experience and expertise in the area of international cooperation, is essential for resolving conflicts of interest and differences of views on countries' shares of funds and reaching consensus among ASEAN + 3 members in the CMI multilateralisation process. With regard to the review and adjustment of international standards, including payment and settlement criteria and capital adequacy ratios, regional countries can maintain

¹³ Considering that the IMF conducts its surveillance of member countries only once or twice every year, for about two weeks, surveillance of regional countries is not adequate in terms of its intensity and frequency.

close relationships with the BIS. They can then utilise the major meetings and expert committees of the BIS to advance their interests by, for example, asking that greater consideration be given to the uniqueness of regional economic conditions.

4. Establishing a long-term vision

Asian countries have promoted a variety of cooperative projects, in recognition of the importance of regional financial cooperation in an era in which both globalisation and regionalism are deepening. However, there has been no clear consensus, either within a single regional forum or among them all, on a common goal or vision that they should pursue in the long term through regional financial cooperation. Having a properly set long-term goal would enable them to formulate strategies to achieve that goal effectively and with the minimum political and economic costs.

If there is a lack of consensus on a long-term goal or direction among member countries, the driving force to achieve that goal might be weakened, or the process might result in considerable trial and error. This lack of a long-term vision seems to be one of the reasons that the cooperation pursued recently by major forums in the region has failed to take off, despite their experiences accumulated during the past decade.

Of course, it is not easy for countries to form a consensus on long-term visions requiring common understanding and efforts, such as AMF establishment and regional monetary integration. This is because Asian countries differ in their development levels, their cultures and their languages, and there are various historical and political conflicts among them. For example, countries have tended to avoid officially discussing the issue of regional monetary integration, as they might incur huge political and economic costs in the short term during such discussions, while their benefits would be uncertain and could be realised only over a long period of time.

At the current stage, therefore, member countries need to engage more actively in research and discussions, in order to arrive at a long-term vision of regional financial cooperation that they can share, and to increase their understanding of that vision. The topics for such research and discussions can include the establishment of a regional foreign exchange cooperation system, regional monetary integration and the scope of the participants to be involved in regional financial cooperation.

IV. Conclusion

The progress of regional financial cooperation since the Asian financial crisis has been slow, but there have been visible outcomes, although on a limited scale. In this process, Asian countries have also been able to accumulate experience related to regional financial cooperation. In particular, the efforts of ASEAN + 3 to set up a financing framework based on the CMI-BSA, and its multilateralisation of that framework, are expected to serve as a cornerstone to the strengthening of a regional risk management system. Efforts in the EMEAP to create the ABF, and endeavours by ASEAN + 3 to foster a regional bond market including the ABMI, will contribute greatly to improving the region's financial markets and enabling smoother financing and management of funds.

Obstacles to long-term cooperation processes have, however, recently emerged in various regional forums. Countries therefore need to strengthen their capacities to operate and develop the already established regional financial cooperation frameworks more effectively, rather than trying to find new areas for cooperation. To reduce inefficiencies, including the overlapping of agendas due to the diversification of regional cooperative forums, the forums need to readjust their projects and focus more on key projects in consideration of their own areas of expertise and their driving forces.

For instance, the establishment of regional surveillance and monitoring frameworks has been pursued by both ASEAN + 3 and the EMEAP. ASEAN + 3 could focus on its financing function and strengthening of bilateral surveillance (between ASEAN + 3 and its individual members), in cooperation with the IMF. The EMEAP, meanwhile, needs to learn from the surveillance activities of the BIS as a role model, and focus on information exchange and monitoring of areas in which central banks have expertise, including the financial markets, payment and settlement, and banking supervision, to promote greater regional monetary and financial stability. If the connections between the various regional forums increase, regional financial cooperation can be promoted more effectively through synergy effects. Therefore, the forums need to engage more actively in official information exchanges. In addition, they would be able to expand the basis for cooperation in the long run by utilising regional central bank training organisations such as the SEACEN Centre, and thus increasing countries' understanding of and interest in the overall financial cooperation projects being carried out currently.

Just as Germany and France played leading roles during the European Union's long economic integration process, major countries in the Asian region need to show their strong leadership and gather the political willpower to make regional financial cooperation successful in the future. The leading countries in terms of economic size and level of economic and financial development should show their leadership. At the same time, they need to be careful not to undermine regional financial cooperation by harmonising all the cooperation processes.

Asian countries can be expected to develop their relationships for regional financial cooperation further in the near future. However, there has been no clear agreement on the ultimate goal of regional financial cooperation, even among the countries participating in it. This is because there are many constraints that cannot be resolved in the short term through the capacities of cooperative forums alone. Financial cooperation in the Asian region so far has not been conducted step by step, in accordance with any long-term plan. Instead, for a decade since the Asian financial crisis, it has centred on projects in which countries can actually cooperate with each other, by reflecting and adjusting the interests of many countries. Therefore, countries need to start with tasks that realistically can be agreed upon, instead of rushing to set up an ultimate goal for regional financial cooperation.

Considering that it took more than four decades for the European Union to complete its economic integration, and that Asia's environment for integration is more heterogeneous than that of the European Union, it will not be easy to reach agreement on the ultimate goal of regional financial cooperation. If countries hurry to try to specify such an ultimate goal, conflicts of interest among them could arise, and this might hamper many of the monetary and financial cooperation projects currently under way. If there is no ultimate goal for regional financial cooperation, however, this could lead to negative side effects, including weakening our driving force and ineffective management of human and physical resources. Efforts to minimise these effects are therefore needed.

In selecting and promoting individual financial cooperation projects, consistency with an ultimate goal must be considered from the mid- and long-term perspectives. To this end, countries need to continue research and discussion on mid- and long-term challenges, including the establishment of a regional foreign exchange cooperation framework and regional monetary integration, even if it takes considerable time to reach a conclusion.

Member governments can face many constraints in actively promoting tasks that require political judgment or on which regional countries have differing opinions. In contrast, central banks can advance the related discussions relatively freely, through objective research and review. In this regard, central banks in the region have many contributions to make to regional monetary and financial cooperation.

Appendix: Key reforms to foster regional financial integration in Asia

1. Current state of regional financial integration

Asia's real sector integration is remarkably advanced, with intraregional trade accounting for about 50% of total trade. Asia's financial integration with the world is also well advanced by some measures, including net private capital flows, foreign participation in some markets, and stock market correlations. Meanwhile, Asia's intraregional financial integration – measured by, for example, cross-border capital flows, or cross-border correlation of consumption growth¹⁴ – has been more limited than elsewhere. The volume of intraregional cross-border portfolio investment in Asia is relatively small compared with that of either North America or the European Union.¹⁵

Although cross-border interest rate and bond yield differentials have narrowed in recent years, they remain substantial. Co-movements in Asian interest rates and bond yields have increased, but this could also reflect increasing integration with the global market and/or improving fundamentals. Empirical studies (Mercereau, 2005) find that consumption growth in most Asian countries has a low or negative correlation with that in other Asian countries. This is in contrast to a correlation of about 0.6 among euro area countries.¹⁶

2. Key reforms to foster regional financial integration

Financial services are conditioned by a host of factors such as cost and availability of funds, transparency, well developed infrastructure, prudential regulation, and market openness. Considering this, key reforms to foster regional financial integration are as follows:

- Strengthen capital markets to increase investor sophistication and improve the investment climate
 - Strengthen the investor base by increasing the role of institutional investors such as pension funds
 - Strengthen corporate governance for an attractive investment climate
- Build regional infrastructure to facilitate trading
 - Link clearing and settlement systems
 - Ensure standardised ratings and a more complete coverage
- Minimise risks associated with greater integration
 - Move towards risk-based supervision
 - Address cross-sectoral and cross-border issues and coordinating crisis management

¹⁴ Increasing financial integration should reduce the volatility of consumption growth relative to income, through diversified asset holdings and source of income. In this way, consumption patterns will be better correlated across countries.

¹⁵ For example, Asia's intraregional cross-border portfolio liabilities amounted to only 2.25% of its GDP in 2004, less than one third of its liabilities to either North America or the European Union.

¹⁶ Cowen et al (2006), p 8.

- Remove impediments to cross-border activities
 - Further capital account liberalisation
 - Further financial services sector liberalisation
- Harmonise rules and practices across the region
 - Address differences in laws, regulations, and tax treatments that deter investors
 - Implement global standards and best practices

Table A.1

Key reforms to foster regional financial integration

Greater financial market integration				
Deeper and more resilient capital and financial markets				
International and regional cooperation				
Strengthening capital markets	Building infrastructure	Minimising risks	Removing impediments	Harmonising rules and practices
<ul style="list-style-type: none"> – Pension sector reforms – Strengthening corporate governance 	<ul style="list-style-type: none"> – Clearing and payment systems – Credit rating agencies 	<ul style="list-style-type: none"> – Moving toward risk-based supervision – Addressing cross-sectoral & cross-border issues – Safeguarding market integrity 	<ul style="list-style-type: none"> – Capital account liberalisation – Liberalising trade in services 	<ul style="list-style-type: none"> – Implementing global standards and best practices
Preconditions				
(eg, sound economic, legal and judicial, accounting, and auditing frameworks)				

Source: Cowen et al (2006).

References

Cowen, David, Ranil Salgado, Hemant Shah, Leslie Teo and Alessandro Zanello (2006): "Financial integration in Asia: recent developments and next steps", *IMF Working Papers*, no 06/196.

Mercereau, Benoit (2005): "Financial Integration in Asia: the risk-sharing gains for Australia and other countries", *Australia: Selected Issues*, IMF country report, no 05/330.