

Workshop on Framework for Regional Monetary Stabilization in East Asia

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Recently a considerable number of requests have been heard from East Asian countries for arranging a regional monetary and financial cooperation in East Asia, based on the harsh experience during the latest financial crises. But there seems neither idea nor view presented to the public that suggests functions and mechanism of such a regional cooperation. A detailed framework for the cooperation can be drawn only when its purpose is clearly declared and gets consents widely in the region.

The Institute for International Monetary Affairs (IIMA) held a workshop in Tokyo on July 7, 2000 on a theme of "Framework for Regional Monetary Stabilization" in East Asia. IIMA intended to provide an opportunity for intensive discussion and mutual understanding among East Asian countries on the theme of regional cooperation. The workshop was arranged with participation from think tanks, academic circle, government offices, and central banks of Japan, China, Korea, ASEAN countries, as well as from the IMF and the World Bank.

This paper is a summary of the presentations, comments, and discussions at the workshop as a record, and is expected to help deepening the discussion in the region in the future. As the writer at his discretion summarized each presentation and comment, and discussions, all claims on the contents of the paper if any should be addressed to the writer.

1 Suggested Function of the Framework

1) Presentation

Dr. Chalongphob Sussangkarn
President

Thailand Development Research Institute Foundation, Bangkok

The Chiang Mai Initiative is a significant political step toward greater financial and monetary cooperation in East Asia. The Initiative signifies a willingness of the group to work together to forge greater cooperation in order to prevent and deal with future economic crises that may affect the region.

The Initiative could be a first step toward the setting up of an East Asian monetary arrangement. I like to call it “Framework for Regional Monetary Stabilization (FRMS)”, which is to be proposed by Mr. Hiramatsu at his presentation later on. An important point is that if an FRMS is to be set up, the key is to reach consensus within the region on its rationale, functions and formats. There is no need to try to reach a global consensus on the idea.

Possible functions of the FRMS include policy dialogues and regional surveillance, monetary policy coordination in the region, emergency liquidity support (or even lender of last resort), extension of loan guarantees to member countries, strengthening credit rating capabilities, promotion of the usage of regional currencies or indices of regional currencies in intra-regional trade and investment, development of currency settlement systems, development of a regional framework for management of short-term capital flows, promotion of regional capital markets to recycle surplus saving in the region for long-term development financing, and work related to possible regional monetary integration in the longer term.

The various suggested functions could be broadly separated into three groups. (1) Initiatives that may help in preventing the reoccurrence of a future financial crisis in the region, (2) measures to be taken when some countries face financial difficulties or get into a crisis, and (3) some form of possible longer-term monetary integration in the region. The FRMS should be able to make rapid and effective progress on the first group of functions, and this should be the main focus at the beginning. The second and third groups require a lot more analyses and discussions to come up with consensus on the details, and practical and effective implementation plans. Technical work on these latter issues can also be part of the short-term agenda for the FRMS.

If an appropriate surveillance mechanism together with the willingness of various governments to pursue appropriate policies can be established through the FRMS, and countries simply face temporary liquidity problems, then having the FRMS provide the needed liquidity creates no problem. However, when a major currency crisis occurs, it is usually because of the failure of the surveillance mechanism to foresee the crisis, or because governments are unwilling to take appropriate corrective policies for political or other reasons. In such cases, the problem usually becomes an insolvency problem and not a liquidity problem. Cases of insolvency should still be left for the IMF to manage.

Building on the Chiang Mai Initiative, greater policy coordination, the development of regional capital markets and supporting infrastructures, and the promotion of regional currencies or currency indices would take East Asia much further toward greater financial and monetary integration than could be imagined only a few years ago. The impetus obviously arose from the crisis, but the outcome could lead to a much stronger and more resilient East

Asia for the century ahead.

2) Comments

Mr. Jie Sun

**Senior Research Fellow, Institute of World Economics & Politics
Chinese Academy of Social Sciences, Beijing**

I agree that setting up some kind of framework for multi-cooperation in Asia will be a politically acknowledged decision of countries in the region and so there is no need to try to reach a global consensus on the idea. I also believe that there is no need for such a framework to act in accordance with the IMF because such a multi-cooperation in Asia as the FRMS is a supplement to the IMF and other IFIs' functions. Functions of the FRMS suggested by Prof. Chalongphob are excellent and practical while I think sequencing of the cooperation in the region should be in reverse order.

The first step to start the cooperation is a regional framework for management of capital flows. As we have diversified exchange rate system among countries in Asia according to economic development level, it is hard to coordinate exchange rate policy in the region right now. It is also hard to image that cooperation among countries can be achieved with different capital control policies. Because any additional shock of another crisis would badly affect countries in the region, we should start management of capital flow at an easier stage, which is also crucial for the multi-cooperation.

The second step is a common currency for the purpose of promoting intra-regional trade and investment. It is something like internationalization, or more precisely speaking, regionalization of the yen or any other currency of leading countries in the region. This is also a precondition for development of regional securities markets. After we have a regional financial market, we can have a benchmark for surveillance and coordination. Regional surveillance is somewhat easier than that of policy coordination.

I believe liquidity support during the crisis is not the main objective of the FRMS, as it is not the focus of the regional multi-cooperation but one of the key roles of the IMF. Any tiny liquidity shortage may contain risks of growing into an insolvency problem. Liquidity support by the FRMS will inevitably raise problems of conditionality and asymmetric usage of funds among countries in the region.

Key functions of the FRMS should include financial market integration and its sequencing as well as surveillance. Only after the financial market integration, we can see effective and real policy coordination in the region. And after that there comes a multi-integration. As such, the regional cooperation in Asia should start from the trade area and go to financial markets, proceeding into broader fields.

3) Comments

**Dr. Djisman S. Simandjuntak, Executive Director
The Prasetiya Mulya Graduate School, Jakarta**

Knowing the different stages of development and the monetary policy divergences in East Asian countries, Dr. Chalongphob's suggestion on gradualism is understandable. In the wake of deepening global integration of the financial system accelerated by an increasingly affordable and user-friendly IT infrastructure, the role of government in monetary stabiliza-

tion is changing away from activism toward prudential regulation. Dr. Chalongphob's suggestion on crisis prevention as the core of the emerging East Asian FRMS fits in well into the changing environment.

To minimize the probability of occurrence of a crisis, transparency in monetary policy making is a prerequisite. Reliable and timely information is needed to enable monetary authorities and participants in the financial system to understand risk-return profile in the respective members of the FRMS. Different measures to be taken to improve the availability and timeliness of such information include: (1) Gap analysis in the laws and regulations governing the financial system, using global best practice as a benchmark; (2) The construction of an Early Warning System covering monetary policy, government budget, banking, financial position of corporations and other related indicators; (3) Periodical survey on the quality of governance in financial institutions and corporations; and (4) A periodic financial policy review.

As even the best system of monitoring is doomed to be incomplete, the FRMS will have to include also measures to be deployed in time of crisis. As the enthusiasm about the FRMS is hard to secure unless the incentives are clearly spelled out, I would suggest that the FRMS should put crisis prevention together with crisis management as a block that needs to be addressed simultaneously as its functions.

The issues of monetary integration should not be left untouched in an argument of the FRMS while they are certainly rather sensitive to touch.

Stronger macroeconomic policy discipline is a universal need in the emerging new economy. Committing oneself to such a discipline and seeking to reach a certain level of policy convergence may find interested audience among policy makers, researchers and business practitioners. They include for instance a range for government deficit, a range for the stock of debt, a range of inflation rate or even a target zone for exchange rate movements.

2 Suggested Operation and Organization of the Framework

1) Presentation

Mr. Taku Hiramatsu

Chief Economist, Institute for International Monetary Affairs, Tokyo

While we believe that the Chiang Mai Initiative is very important as a first step in establishing a regional framework for policy cooperation and mutual financial support in East Asia, it would be also quite important for those, independent of the authorities, to propose some kind of framework with concrete contents for further discussion. An idea of the operation and organization for such a framework is shown as follows;

Name: The Framework for Regional Monetary Stabilization (FRMS)

Operation:

The FRMS should have two primary pillars in its operation: i.e. economic surveillance and liquidity support, as well as research and studies.

-Surveillance

The FRMS will conduct periodic regional surveillance, which will accelerate the economic reforms of member countries, encourage them to maintain sound policies and strengthen their resilience against crises through mutual "peer pressure." The FRMS's surveillance will enhance the scope of "on-the-ground" studies, and various economic-policy

areas of member countries should be reviewed, including fiscal, financial, monetary policies, supervisory measures for banking sectors, as well as economic and financial environments.

Policy recommendations prepared by the FRMS are assessed by the FRMS consultation committee, which is organized by member countries and international financial institutions (IFIs), such as the IMF, World Bank and Asian Development Bank, as observers. Member countries will be expected to adopt these recommendations. The FRMS will also make efforts to develop an early-warning system, to help predict and prevent balance-of-payments crises.

-Liquidity Support

When a member country is actually hit by a crisis, and faces a foreign currency shortage in spite of the efforts mentioned above, the FRMS will quickly provide it with liquidity in foreign currency or a member country's currency, to prevent a draining of its foreign reserves and stave off a nose-dive of its exchange rate. Financing by the FRMS should be short-term oriented. Conditions are to be attached to the disbursement of liquidity support. They would be devised mainly from the results of its surveillance and desirably contain private sector participation in consultation with the IMF.

-Research and Studies

The FRMS will undertake research and studies pertinent to financial and monetary issues in the region, such as capital-account development and financial-sector issues, foreign exchange rate regimes and so on.

Organization:

-Members

ASEAN+3 countries are expected to be the founding members of the FRMS, but any other country that commits to lending the FRMS funds for liquidity support, and pays an operational fee, may be welcomed as donor membership. Any country that does not commit to lending, as well as IFIs, is welcomed as an observer without voting power.

-Organization

The FRMS will have a General Meeting as the highest decision-making body, as well as a Board of Executive Directors and a Secretariat. No single country should have veto power in weighted majority voting.

-Staff

Staff will be composed of officers seconded from member countries' monetary and financial authorities, banking supervisory agencies, as well as economists and assistants recruited within the region. Personnel should hold nationality of the member countries.

-Source of Funds for Emergency Lending

It is recommended to establish standing borrowing arrangements, similar to the IMF's General Arrangements to Borrow, between member countries and the FRMS.

-Expenses

To cover the operational costs of the FRMS, member countries and observers (other than IFIs) will be charged an annual fee.

2) Comments

Dr. Jesus P. Estanislao

Professor, University of Asia and the Pacific, Manila

The concept of the FRMS as outlined by Mr. Hiramatsu is fairly simple and very clear.

First, we want to prevent a financial crisis from reoccurring and if it reoccurs we want to prevent it from causing such devastation and causing such great instability in our part of the world. Second, in East Asia, we would like to work together, forge an agreement, come to an arrangement which enables us to provide liquidity support for economies that might be subject to speculative attacks. Third, we want the arrangement to be for East Asia, by East Asia, and in fact to be run and operated by East Asia as a region. And that is why we are emphasizing regionalism. If we can all agree to all of these basic propositions, we simply say this is our concept whether others will like it or not, and we will simply go ahead and try, implement and pursue these concepts.

We have to be extremely careful as to what the functions are. First, when we go into functions, let's be realistic, because in the process we might kill the baby before it is able to grow up. Second, the coverage of surveillance should be comprehensive enough. We should worry about corporate governance, the strength of industries, the flexibility of corporations and institutions that operate at the microeconomic level of the economy. Third, we should keep the regional spirit in mind and that is at the bottom of anything that we do. Because if we do not go beyond our national economies, then it will be very difficult to succeed in this mechanism. Fourth, It will take a lot of time if we start the mechanism with all 13 countries in ASEAN+3 from the start. I propose to simply say it is open to everybody in East Asia, but let a pioneering group go ahead and let everybody else come and join. Fifth, we have to be clear what we can agree on. Let's be clear as to what standard is. If we agree what standards are, we can move ahead. Sixth, as this is for East Asia, we should not open it to outside East Asia such as Australia and New Zealand. It is about time that we have something that is truly East Asian in character.

3 Positioning of the Framework

1) Presentation

Mr. Kiyoshi Miura

Chief Economist, Institute for International Monetary Affairs, Tokyo

Functions of the FRMS are devised to strengthen the immunity of its member countries against future crises and, in the event of such crises, to swiftly inject liquidity into crisis-hit countries within the region. To achieve its goals, the FRMS, keeping its independence, will be prepared to establish and maintain close cooperative relationships with existing IFIs such as the IMF, the World Bank, and the ADB; the FRMS may provide support to such IFIs in certain cases, and may also ask for assistance from them in other cases.

The FRMS will be ready to provide IFIs with the results of its regional surveillance, as well as its studies and researches on various issues in the region, to contribute to better understanding of the latest economic, financial, and social situations of member countries. The FRMS will expect in return to have easy access to data from IFIs, especially their surveillance, which will surely benefit the FRMS in deepening and enriching its own surveillance and recommendations to its member countries.

The FRMS will also be ready to cooperate with IFIs in monitoring implementation of policy recommendations prepared by IFIs for member countries, and in arranging and managing financing to members. The IMF, the World Bank, and the ADB will be expected to participate in a consultation committee to be established by the FRMS, in which all surveil-

lance reports are to be discussed and all policy recommendations are to be checked. The FRMS will be ready to receive staff seconded from IFIs, who will join in surveillance teams of the FRMS contributing to the success of the surveillance with their expertise.

Relationship with the IMF:

Since the FRMS will have the same objectives of the IMF as multilateral financial institutions (i.e. prevention and resolution of crises), the relationship with the IMF will be most important to the FRMS. These two institutions should maintain close communication with each other, to minimize differences in their observations and understanding of economic, financial, and social circumstances in member countries. Such differences could have major effects on the recommendations and conditions to members, which could cause confusion and, at worst, create moral hazards. The principle of maintaining close communication with the IMF will enable each of the two financial institutions to establish efficient and effective conditions to any crisis-hit country, without crucial discrepancy.

When emergency lending is needed in case of a crisis in the region, the FRMS will endeavor to inject liquidity into the crisis-hit country, keeping close communication with the IMF. The IMF will be expected to cooperate with the FRMS, for smooth implementation of such cooperative financing.

Relationships with Countries in the Region:

East Asian countries are expected to participate in the FRMS as its members. Each member will be requested to provide the FRMS regularly with the latest information on its domestic economic data, with human resources, and with money to cover allotment of operating expenses and emergency lending in case of a crisis. Member countries will especially be expected to accept and observe policy recommendations by the FRMS.

Relationships with Countries outside the Region:

The FRMS will keep the door open to non-East Asian countries that sympathize with objectives and philosophy of the FRMS and are willing to provide it as donor countries with various supports including sharing the burden of expenses and rescue-package disbursements.

2) Comments

Dr. Masahiro Kawai

Chief Economist, East Asia and the Pacific Region

The World Bank, Washington, D.C.

I like presentations by Mr. Miura and Mr. Hiramatsu as they address a global framework for regional financial management in comparison to the original idea of Asian Monetary Fund. When the crisis in East Asia broke out, various attempts were developed to strengthen regional financial and monetary cooperation. The AMF proposal turned into the Manila framework that has no formal mechanism of liquidity support and focuses on the surveillance part. The New Miyazawa Initiative is focused on not only medium-term and long-term financing for crisis resolution of the affected countries but also short-term liquidity provision. The Chiang Mai Initiative has been mentioned by many speakers. An important point is deepening trade and investment linkages and the macroeconomic intra-dependence in East Asia. East Asian economies are increasing their intra-dependence in the area of macroeconomic and also financial linkages. If you take a look at the correlation coefficients of exchange rate movements from July 1997 and onward, correlations among the East Asian

countries are much stronger than other correlations in other parts of the world.

Another point is the fact that despite globalization is deepening, there is no effective lender of last resort. The IMF is not a full international LLR in its strict sense. East Asian economies have large amount of foreign exchange reserves, and they can use their foreign exchange reserves to fight against speculative behavior.

As emphasized by Mr. Miura, to conduct effective surveillance in East Asia, involvement of the IFIs such as the IMF, the World Bank, and the ADB is essential. The presence of the IFIs is very important because of not only the need to monitor and to do surveillance over the regional economies but also to make assessments on external environment including the US economy, European economy, other emerging market economies and also the state and conditions of international commodity markets, international financial markets, risk assessment of global investors and so forth. All these elements will have to be incorporated in the surveillance system. And for that sense, the IMF, the World Bank, would have to play much more important role than perhaps Mr. Miura is envisaging.

When a crisis takes place, the first task that needs to be done is to identify the gap of balance of payments equilibrium, and the IMF has been typically doing it in many cases with good reputations and credibility in the global market. If one of the causes of the crisis is in the structural part, we has to really get into deeper part of the problem rather than just simply focusing on macroeconomic policy. For that purpose, involving not only the IMF but also the World Bank and the ADB would be quite important.

Next point is that in the process of involving private sectors in resolving external debt problem. Mobilizing global investors in the process of external debt resolution can be a very important part of crisis resolution. I am just skeptical, however, if a regional arrangement can handle this issue. Korean government representing the Korean interest negotiated with that of international creditor banks under the supervision of the IMF, and the involvement of the IMF gave a great deal of comfort to global investors.

Lastly, if a currency crisis is deep-rooted, a more comprehensive program is needed beyond the one that may be put by the regional institution. And such a broad, more comprehensive program would require the IMF and the World Bank to clearly step in. That is another reason why global IFIs such as the IMF and the World Bank should be involved from the beginning of any liquidity support operation. In order to make such an institution work, capacity building on the part of the FRMS itself is needed because surveillance is not an easy process and setting up conditionality is even a more difficult process. IMF staff secondment in the FRMS is a good idea. The membership should be widened to include Asian Pacific countries think this comment is consistent with Mr. Miura's. The ending comment is that the IFIs need to be involved for effective surveillance, strong conditionality, and efficient private sector involvement.

4 Conditionality and Moral Hazard

1) Presentation

Dr. Luiz A. Pereira da Silva

Principal Economist, The World Bank, Tokyo Office

While the term “Moral Hazard” (MH) has been used quite extensively to explain “excessive” risk-taking behavior by borrowers and creditors prior to the outbreak of the

Asian crises, the usage of the term has been quite loose. In a nutshell, in the presence of insurance to cover any accident, the behavior of insured parties can be imprudent because they will not bear the full cost of their actions. The losses resulting from the accident would be more than offset by the net benefits from the insurance. In particular, it was used to explain financial crises linking them to the past “imprudent” behavior of borrowers, creditors, depositors, investors, corporations, banks, etc. These agents' behavior arguably had been affected by the presence of “insurers” such as Governments and even IFIs including the IMF as an international or global “lender of last resort (LLR)”.

MH became part of the argument explaining the formation of large financial bubbles in emerging markets, particularly in East Asia. MH “explains” why there was “over-borrowing” and “over-lending” precisely by the private sector before the Asian crises, and why it became a determinant factor in the built-up of financial vulnerabilities.

Could MH arise if an international LLR like the IMF during the resolution of a crisis rescues private creditors in an indiscriminate and generous way? MH from international (multilateral) financial support is considered a sub-set of MH arising from any public support. The first idea is that large international rescue packages give the impression that private creditors that took excessive risk (lending and borrowing) are bailed-out with public money during a crisis from (at least) a portion of the losses that they would have otherwise incurred. Bailouts can happen but it does not mean that the excessive risk taking was caused by them. The second layer of the argument is that large rescue package can create the “expectations” of future rescues and that possibility could function as an incentive to increase risk taking in lending and borrowing. The “expected” protection that lenders could rely upon for these flows was linked to the “expected” stability of macro-economic policies of local governments, not from IFIs.

We challenge the claim that MH played a major role in the international financial dimension of the Asian crisis, explaining both the over-investment and the accumulation of short-term external liabilities that led to the crises. Our research of explaining behavioral changes of the loans from Japanese banks to Thailand, Indonesia, Malaysia and Korea suggests that competition among financial institutions compounded by “Herd Behavior” (HB) by banks can explain most of the East Asian financial bubbles. The research shows that it is possible to explain quite well without using a “moral hazard” hypothesis the over-supply of loans by foreign banks in East Asia. The returned results of a qualitative questionnaire addressed to Japanese banks confirm that the idea of government-backed “implicit guarantees” offered to international creditors (the backbone of the MH hypothesis) are not perceived by Japanese banks as a significant role in their lending decisions to East Asia. Conversely, fierce competition with other banks (particularly European) and HB played the role.

The discussion above leads to the conclusion that there seems to be only a weak (if any) relation between international LLR and MH. Eliminating LLR would have severe consequences for the real economy of countries experiencing crises. Severe local recession, in addition to the local, regional social and political consequences, could also trigger a general financial meltdown. It would also increase the probability of the default of the sovereign, when eventually it becomes liable as local lenders of last resort are responsible for rescuing the local borrowers.

What could be done to avoid the emergence of MH in case that there are conflicting signals and inconsistent conditions given by competing international lenders of last resort either

before or during a crisis? A rationale for a multiplicity of levels in international lending of last resort can be listed as follows;

- a) Regionalized Surveillance. A regional mechanism for monitoring risk can be a very powerful complement to enhance the global surveillance function of the LLR.
- b) Stronger Second Line of Defense. There are already instances where there has been close collaboration between official bilateral agencies and the global LLR (the IMF). In some cases, there has been a commitment from official bilateral creditors to provide line of credit constituting a “second line of defense” of IMF-led programs. The FRMS can cooperate for the IMF with strong commitment as a second line of defender.

The FRMS envisages a separate facility that would be financed by member countries and that could be activated by the organization itself. As general rules to avoid MH, we can suggest the following:

- There should be a carefully discussed and agreed upon identical definition between the global LLR and the FRMS about the criteria that will be used to distinguish a liquidity crisis from other crises.
- There should be also an identical framework and rules for private sector involvement and burden sharing in case of crises.
- There should be also an identical set of rules for eligibility under the swap arrangements from the FRMS.
- There should be coordination with the global LLR to set the overall size of support to an appropriate level that would not create excessive economic contraction or excessive benign adjustment.

2) Comments

Dr. Yunjong Wang

**Director, Department of International Macroeconomics and Finance
Korea Institute for International Economic Policy, Seoul**

Dr. Pereira's paper on the issue of MH and international LLR is very insightful and impressive. Some economists insist that the world financial market is principally unstable without an international LLR, and other liberal economists argue that markets are intrinsically stable and efficient, and the contagion effects are negligible. They think that international LLR would create some greater problem rather than solution with MH by sovereign borrowers as well as international creditors. I support Dr. Pereira's argument that MH is not relevant in explaining the whole story of the Asian financial crisis.

Premature liberalization of the capital accounts without adequate supervisory capacity may increase risks of inducing excess movements of capital flows. In order to prevent future crises, we need to strengthen the monitoring activity. This kind of surveillance will make a clarified information flows to the countries. So the regional surveillance conducted by the FRMS will do some good job and definitely supplement the IMF's global surveillance.

The more important issue is liquidity provisions. Without this kind of liquidity support, the framework will not work well. In doing this kind of regional surveillance, we may face several cases of economic situations; a case of pure liquidity problem, a mixture of liquidity problem and structural problem, and a case where the government will not start necessary structural reforms. To deal with those cases, we should form a working group to discuss var-

ious issues involved and to make some progress in surveillance.

As to coordination of functions between the FRMS and the global LLR, the FRMS should be the first line of defense rather than the second line of defense. But there still may be some credibility issues before the FRMS can become the first line of defense. The FRMS need some credible disciplines in this context.

At the same time, the liquidity support by the FRMS should be more or less confined to a pure liquidity crisis. When a crisis is more serious, more complicated, then the liquidity support program by the FRMS may not be effective to the case in the medium-term. If the situation is so severe as to involve a debt structure problem, the case should be dealt with by the global LLR, the IMF. In such a case the FRMS could contribute to the rescue program as a co-financing agent, which will totally support the IMF's role as the global LLR at a crisis. While it may not be easy to distinguish between a pure liquidity shortage case and a liquidity crisis combined with some structural problem, surveillance conducted by the FRMS will provide useful suggestions in this regard.

3) Comments

Dr. Masaru Yoshitomi

Dean, Asian Development Bank Institute, Tokyo

I strongly support, Dr. Pereira's paper because it is very concrete and specific. MH is just one of the multiple determinants, not necessarily a dominant factor of financial crises. Let's take a look at the latest Asian financial crisis.

The Asian crisis was the so-called twin crisis; it was an international liquidity crisis, and on the other hand it was a domestic banking crisis. Conventional current account crises have been measured by conventional macroeconomic variables, such as inflation rate, fiscal situation, domestic saving rate and so on. To the contrary, if we apply to this new type of crisis (capital account crisis) a traditional policy prescription that was effective to conventional current account crises, such an old medicine would worsen the condition of the patient economy. Even the same policy prescription will improve a crisis-hit economy in one case and worsen it in other cases, depending upon the nature of the crisis. In case of a capital account crisis, the FRMS should provide the crisis-hit country with ample liquidity at more timely manner.

The latest facilities provided by the IMF would not be sufficient enough to cope with the needed provision of international liquidity in massive and timely manner. The IMF is not necessarily equipped with enough resources and facilities to deal with such a situation where a chain of financial crises takes place in many countries simultaneously as seen in Asia, Russia and Brazil in 1997 and 1998. As the IMF cannot print international money, it cannot be a genuine global LLR. While in a political sense I am a bit afraid the IMF would not be really interested in helping any country in Asia without being supported from the United States, the Asian countries have to rely on a multilateral financial framework headed by the IMF, as there seems no leading "mother country" in the region. As the result, we may have to supplement insufficient functions of the IMF with some regional arrangements.

Surveillance is a precondition for receiving a liquidity support in case of a crisis. If a member country of the arrangement satisfies surveillance criteria, access to that regional facility should be immediately available for the requesting member country without any conditionalities to be attached. When a domestic bank faces liquidity shortage, the central bank

swiftly provides liquidity to the bank in trouble without clearly knowing if the bank is solvent or insolvent. Similarly at a crisis, in order to prevent a systemic crisis from recurring and to prevent initial depreciation of the exchange rate from aggravating balance sheets of domestic enterprises, we need to first intervene in the foreign exchange market with ample liquidity provided by the regional arrangement hopefully together with the IMF. Once we succeed in extinguishing the liquidity crisis, we should investigate causes of the crisis in details, and impose conditionalities for the country at issue requesting its government to implement structural reforms necessary. Conditionalities should be attached even after satisfying surveillance criteria, because at the time of the crisis, we have to provide international liquidity without clearly knowing whether it is insolvency crisis or liquidity crisis. With those conditionalities and good surveillance mechanisms, we can avoid MH successfully.

5 Discussions

The discussion on the framework for regional financial cooperation that followed the presentations and comments are summarized in accordance with main points as below;

1) Naming

- As we are talking about an institution of Asia, for Asia and by Asia, it sounds very odd if the word “Asia” does not appear in the title. “The Asian Monetary Fund (AMF)” is still the right term for the title of this institution.

2) Membership

- As Hong Kong and Taiwan are part of East Asia geographically or by any criteria, and they participate in the ADB, it is worthwhile to consider having them being part of the framework.
- Membership should be discussed seriously from the beginning, as it will become very important when the framework deals in the future with such issues like monetary integration within the region.
- As this is an initiative of East Asia, it would be mysterious if the US and Australia were in the framework.
- Membership should be discussed in consideration of functions that the framework is expected to have, as the framework has to be well equipped with facilities and resources sufficient to deal with future financial risks in the region.
- The US participates in several fora in East Asia, and East Asia has maintained close relationship in various areas with the US for long.
- If countries outside East Asia including the US can make a commitment to resource infusion, the framework should open its door to those countries.

3) Functions

- We should proceed toward monetary integration in the region as its long-term goal. In the transition to the goal, we should pursue a currency basket exchange rate regime for stabilizing exchange rates in the region.
- The framework should make every effort in promotion of financial market integration in the region, starting with standardization of capital control policy.
- We should enhance monetary cooperation and trade cooperation in the region in a

well-balanced manner.

4) Liquidity support vs solvency support

- Several people suggest that some type of regional fund would handle the liquidity shocks and the IMF would come in possibly later and handle the more difficult solvency shocks. It is, however, very hard to distinguish these two types of crisis shocks.

5) First line of defense vs second line of defense

- We should deepen the argument on the responsibility that the FRMS is to undertake in liquidity support to a crisis-hit country; whether the FRMS should play as the first line of defense or the second line. It relates to the basic concept of the framework.

6) Moral hazard

- It is correct that moral hazard is not sufficient to cause the non-conventional crisis. At the same time, it should be noted that, when you have this sort of financial crisis, there is always moral hazard.

7) Credibility

- It is doubtful that a regional arrangement established for financial cooperation in the East Asia can obtain enough confidence from outside the region as most countries in East Asia do not have a strong and sound financial sector domestically yet. Each member country of the framework should promote structural reforms including its financial sector, and enhance disclosure.

8) Level issue

- With regard to problem resolution, there are three different levels for such resolution: international level by IFIs, country level by each country's domestic policy, and regional level by regional framework. We should study what is the extra value added from initiatives at the regional level.

9) Sequencing

- As the FRMS proposal is very ambitious, it will take a lot of time to realize its goal. Sequencing or staging will be quite important for implementation of such a framework.

10) Adjustment with domestic policies

- Promotion of international cooperation often requires sacrificing some of domestic policy objectives. We should devise procedures and process to minimize such sacrifices.
- Regional interests are not necessarily equal to national interests of each country in the region. This is why we should really have discussions and active dialogues both at the government level and the private sector level.

11) Surveillance

- Surveillance leads to policy coordination. The first step for success of surveillance and policy coordination would be policy communication.
- To implement surveillance successfully, there needs a previous agreement on its purpose and reason among participating countries in the framework.
- While peer pressure is quite important for surveillance, it is rather doubtful whether Asian people can put peer pressure effectively as they tend to refrain from speaking harsh words toward their neighbors. The IMF and the World Bank can support the FRMS in this regard if they are allowed to participate in FRMS's surveillance.

12) Cooperation vs coordination

- We have had various references to cooperation and coordination of policies. As coordination is typically much stronger, it is important to keep these two terms separate for usage.

13) Rationale of a framework for regional cooperation

- The contagion effect during the latest crisis indicates that East Asian economies have been sufficiently integrated. It is important for the countries in the region to share information among them to learn from each other through the framework in the region.

14) Conditionality

- At the time of establishing conditionality to be attached to a liquidity support by the regional framework, a comprehensive rescue program should be behind it. The regional framework will be able to come up with a sensible and reasonable conditionality by incorporating itself with the IMF and the World Bank.

15) Regional currency

- The US dollar needs a contestant. The yen is expected to become its competitor in East Asia in the near future.

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