

# Newsletter



Institute for International Monetary Affairs

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## Creating a Regional Monetary and Financial Institute<sup>1</sup>

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### **I. Foreword**

The fifth annual conference of the Network of East Asian Think-tanks (NEAT), held on August 22-23 of this year in Singapore, seemed to have been a successful gathering, attracting a large number of participants. The ASEAN plus three (APT) deserves credit and much congratulations for its efforts and vigour. The report of the conference along with the policy recommendations that were adopted was presented at the recent meeting of the Council of the East Asian Community. The representatives of the various Japanese institutes who again formed the delegation to the general meeting had put in much effort, and I would like to extend my gratitude and praise for their endeavours.

Needless to say, “T” in NEAT stands for think-tanks and NEAT is an extensive network (“N” in NEAT) of institutes and think-tanks that deal mainly with East Asian issues. But it is also the strength of NEAT that the range of subjects covered by the member organizations extends quite widely even if geographically confined. The six areas of study – financial cooperation, overall architecture of community building, cooperative framework for migrant labour, cultural exchange, investment cooperation and energy security cooperation – included in the policy recommendations reflect this characteristic of diversification though all of them are based on the key concept of strengthening the system of cooperation in East Asia. Many of the APT nations have think-tanks that concentrate on one or more of these areas and I believe such think-tanks

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are expected to actively participate in the working groups related to their areas of study. Those countries which do not have the think-tanks to take part in such discussions are represented by the research departments of their foreign ministry or treasury. This reflects a situation where such governmental departments are the key organizations that deal with the issue and their participation is quite worthwhile.

The policy recommendations adopted at the annual conference of NEAT are to be reported at the next summit meeting of the APT. This is a good indication that the list of recommendations is not just another declaratory document published at the end of think-tank symposiums to conclude the meeting but that it has been taken much more seriously with possible meaningful implications. This document is expected to be a compilation of the most advanced knowledge and experience of East Asian think-tanks. Is there any benefit in creating a network of think-tanks and have them report on the fruits of their latest studies on various shared issues when concrete discussions among governmental departments are conducted expeditiously? I believe such endeavours are worthwhile because discussions at political levels always have limitations due to political considerations, and departmental exchanges would likely have the same restrictions. Think-tanks, on the other hand, are theoretically not bound by such considerations and are expected to have debates based on logic and theory, and to make policy recommendations with an understanding that politics should be left to politicians and executive issues should be left to the executive branch. They are expected to adopt the most pragmatic and theoretically sound development and to look at the medium and long-term interests of the whole region. In past years, when the key currencies adopted the float system, there was concern that the world of foreign exchange had entered the era of navigation without a chart. The East Asian Community is setting out on navigation where there is no chart but the working groups in NEAT are expected to draw the chart to the goal in their respective areas of expertise, and I believe the same is the mission of NEAT itself.

Political compromises will undoubtedly be necessary in the political dealings within the working groups of the Community. I am sure the responsible departments of the executive branch have to take practical steps amidst innumerable responsibilities to implement decisions based on such political compromises. NEAT has to produce goals and charts that allow those involved to feel assured that such compromises and realistic measures are nevertheless steps towards the ultimate goal. In this respect, the importance of NEAT will only increase in the future and many, including the author, count on the organization to develop further.

Let us review the work done by the East Asia Financial Cooperation working

group through the report presented to the general meeting and the policy recommendations.

## **II. Achievements of the Working Group on East Asia Financial Cooperation**

The report dated April 18, 2007 and submitted to the general meeting is presumably a memorandum of the meeting of the working group held in Shanghai on April 17-18, 2007. The WG was sponsored by China. Although the proceedings are compacted into six pages, it is easy to assume that there was a substantial amount of material for discussion. The memorandum covers such a wide range of issues that it cannot avoid giving the impression of being disorganized. However, when read more diligently, it goes some way to clarify the ways to develop financial cooperation in East Asia, and the effort merits recognition. The policy recommendations included in the second half of the memorandum are the basis of the policy recommendations for financial cooperation adopted at the annual conference and should be studied in detail.

The policy recommendations are numbered from one to 43 to make it easier to make cross references. Numbers 14 to 18 are the five items regarding financial cooperation.

No.14: As a step to move beyond Chiang Mai Initiative (CMI), the bilateral swap arrangements under CMI should be turned into standby credit under a multilateral framework. An East Asian Reserve Cooperation Fund should be created and the standby credit should be transformed into this Fund.

No.15: It is strongly suggested that efforts be made to strengthen the functions of CMI on information exchange, policy coordination and capital flow monitoring. It is desirable to expand the APT Finance Ministers' Meeting into a meeting including the central bank governors. NEAT WG on financial cooperation will expand their scope of work to review monetary and financial policy and policy coordination among East Asian countries.

No. 16: Concerning the Asian bond market, an Asian bond market should be developed through capacity building which may include establishing a more effective steering body to guide domestic bond markets; strengthening the infrastructures of domestic bond markets; and, improving taxation and legal environments. Liberalization is key to promote cross-border bond trading.

No.17: It is important to enhance cooperation between government and private financial institutions and in order to promote this objective a Promotion Institution for East Asian Monetary and Financial Cooperation should be set up. Such efforts as development of financial infrastructure and alignment of monetary inspection within the region should

be pursued through this Institution.

No.18: As regards Asian Currency Unit or Asian Currency Unit Index, there are differing views on what constitutes an Asian currency unit but there is general agreement on the need for an in-depth study on the feasibility of an Asian Currency Unit Index. It is suggested that a specialized body designated by the APT countries be responsible for leading this study.

(This is the author's summary, and the full list of recommendations can be obtained on the website of the Japan Forum on International Relations <http://www.ceac.jp/j/pdf/neat-005.pdf>)

Reading these five items among the policy recommendations, I am sure that I was not the only one to feel somewhat perplexed. I do not want to nit-pick but there seem to be three problems.

First, they give the impression that the sponsor of the WG was not up to date on recent developments. Since there is no explanation, the functions of an East Asian Reserve Cooperation Fund mentioned in No. 14 is not clear but it seems to be very close to an Asian Monetary Fund, on which discussions have matured over the past years. It is well known that following the decisions made at the APT Finance Ministers' meeting in May this year, most of the recommendations made in No.14 have already begun to be implemented. Once the CMI has a permanent secretariat, it would become, in effect, an AMF, as the author, too, has eluded to in his previous articles. The recommended policy should have been based on these developments. The same could be said of recommendations related to the Asian bond market in No.16 and an ACU in No.18. Unless the developments in the official or the political arena are taken into account, there is a danger that the discussions among think-tanks could simply be going around in circles.

The second problem is the fact that the recommendations go beyond the functions and responsibilities expected of think-tanks. No.15 recommends expanding the scope of work of the WG on financial cooperation to review monetary and financial policy and policy coordination among East Asian countries. This would be possible only through extended discussions at the various levels of the APT, consolidating the problems related to the issues and clarifying the technical problems, and is precisely the kind of regional surveillance that has begun to take shape. This means that there is no role for think-tanks in this area. If there is any contribution that think-tanks can make, it would be when the authorities responsible for regional surveillance ask them to weigh and

analyze the practical effect of coordinating a specific policy. Such analysis is the job of think-tanks. If the recommendation is based on such a basis, then that should be clearly noted.

The third problem is that the arguments seem too generalized. I can understand that recommendations are based on some extensive thinking on each item, but let me take the regional bond market as an example. There are arguments that means to liberalize bond transactions in the region should be adopted with the aim of integrating the regional bond markets. There is no objection to the goal. However, this would mean liberalization of markets in individual countries, internationalization of the regional currencies as well as liberalization of capital transactions. And this leads to sequencing, i.e. how to prioritize items to liberalize and internationalize, which was the object of much criticism during the Asian financial crisis ten years ago. The development of bond markets in the regional economies is a large issue and a significant challenge, and the region must find a solution in a wider, overall context. Hence, I would not be the only one to feel that the recommendation lacks detailed, sophisticated thinking.

There is also another striking aspect to the list of policy recommendations, which is the number of new structures and organizations that are to be established. Perhaps the East Asian Reserve Cooperation Fund and the Promotion Institution for East Asian Monetary and Financial Cooperation that are mentioned above are renaming organizations that had already been suggested and debated. If so, they should be recognized as such. But the steering body to guide the development of the regional bond market in No.16 and the specialized body to conduct in-depth study of ACU in No.18 are not explained in detail, and because of that, they excite the imagination of the readers. Let us review the idea of creating these two new organizations.

### **III. A Plan for a Regional Monetary and Financial Institute**

Many will remember that in the autumn of 1997 in the midst of the Asian financial crisis, a plan to establish Asian Monetary Fund was discussed, and basic agreement on the concept was about to be announced only to be shelved at the last minute. This scheme had been kept alive among the think-tank specialists in subsequent years. On the official track, the CMI, which is a network to supplement liquidity at a time of crisis, was agreed at the APT Finance Ministers' meeting in May 2000 and the effective creation of an AMF has been planned as a means to provide more meat to the initiative. The expansion of the CMI occurred faster than initially hoped for. The APT Ministers' meeting this year agreed to take the next important steps; the multilateralisation of the CMI and the partial pooling of necessary reserves. Debate on regional surveillance is

also developing at the APT. The establishment of a permanent secretariat is seen as an urgent issue by all those involved, and if such a secretariat should be created, no one could deny that this is precisely the AMF that was discussed a decade ago. I have discussed its history in my last article. If you are interested, I would ask you to refer to it for details.

I have long argued that once an AMF is established, it is critical to create a research division. (Let us call it the AMF Institute.) I have also introduced my arguments in the past that if a steady development of the CMI were to be prohibited for some reason, it could be a pragmatic choice to establish this institute first. However, the CMI is developing steadily without meeting any obstacles and there is no apparent reason for doing so. That does not diminish the necessity to establish the AMF Institute. There are numerous research themes that should be entrusted to the institute, and when the process of establishing a permanent secretariat begins, a simultaneous establishment of this institute should be considered in parallel. It would be sort of a think-tank for the AMF group and would conduct the kind of research and studies which would be difficult for the AMF itself to carry out. Following are the issues that should be entrusted to this institute.

- In relation to the regional foreign exchange policy  
Moving out of the current system centered on the dollar; establishing an alternative means of calculating the value of the home currency; diversification of the currencies used in trade, etc.; promotion of the shared use of the regional currencies; modernization of the settlement system for the regional currencies; and studying the idea of a regional monetary unit.
- Internationalization and deregulation of home currencies  
This is related to the issue of sequencing. Measures to deal with foreign exchange speculation must automatically be considered with the internationalization of a currency. This would include developing the steps to deregulate capital account transactions and measures concerning the integration of regional bond markets.
- Developing the measures to deal with international short-term funds  
This would supplement the responsibilities of an AMF. Improving the accuracy of monitoring, developing a more accurate and sophisticated early warning system, conducting basic research on dealing with emergency situations (including establishing a method to clarify conditionalities), and leading the international opinion on monitoring hedge funds, etc.
- Developing the means to cope with the global imbalance of funds

Aiming to diversify foreign exchange reserves held by the regional economies and promoting an effective utilization of the regional savings within the region.

- Developing the means to foster the financial markets and long-term capital markets of the regional economies. This would include the nurturing of the regional institutional investors, developing the infrastructure to achieve organic integration of the various markets in the region and streamlining the settlement system.

These are some of the issues that come immediately to mind as those that the institute should study, but more items would probably come to mind. AMF would be an organization to act with authority and power. And if such AMF were to conduct its own research (this is admittedly necessary if it were to fulfill its function) on a specific issue, the political intention of AMF would likely become the focus before there could be a productive debate on the issue itself. (The specific issue could be a study on adopting a basket composed of the yen, euro and dollar to measure the value of a regional currency in place of the dollar centered system that is, in effect, used currently.) However, there would be virtually no objection to the AMF Institute analyzing and studying the same issue from a purely academic point of view. This is the rationale for separating AMF, which would be the executive organ to carry out policies and debates, and the AMF Institute, which would be the intellectual group supporting AMF.

What then is the relationship between the AMF Institute and NEAT? I would like to suggest that the institute become a member of NEAT WG on financial cooperation. The AMF Institute would have the characteristics of a think-tank and, if it were to carry out the various functions mentioned above, perhaps the activities by NEAT in this area would become unnecessary. However, it would not be prudent to think that such a shift would occur as soon as an institute was established. When NEAT WG wants to involve researchers from a wide range of countries to participate in studies or logical analysis on a specific issue, it would be possible to have an arrangement where the WG would wait for the AMF Institute to point out a problem and provide basic information (such as how far the issue has been developed to date), then conduct a thorough research on the subject. If this could be the scenario, NEAT WG on financial cooperation would long be an invaluable partner to the AMF Institute.

Looking at the steering body to nurture the regional bond market and the special body to create a regional currency unit, which were included in the policy recommendations, some of the functions that would be entrusted to these new organizations could become the responsibility of AMF and others could be issues that would be best dealt by the AMF Institute together with NEAT WG on financial cooperation. The policy

recommendations, especially with the suggestion of the creation of new organizations, provided a good stimulus for those involved in the discussion on financial cooperation in East Asia.

#### **IV. In place of a conclusion**

There have been many discussions on the cause of the Asian financial crisis over the past ten years. The view depends on the individual outlook on the current situation. I would like to conclude that the problem stemmed from the fact that a dollar-centered international financial situation had been created in the region. And the current situation is not that different from that before the crisis. This can easily be seen from the fact that the currency of trade and settlement, capital transactions and foreign reserves is still the dollar by and large. There is also the stark reality that the foreign exchange market in individual countries can only be established against the dollar. On the other hand, the economic situation in the United States is quite serious from the point of the speed with which foreign debt is increasing as well as from the point of the accumulated amount. The navigation without a chart must aim to lead to a serene but sure departure from the dollar-centered system.

I hope that the importance of a strategic departure from the dollar would be deeply embedded in the minds of the institutions and individuals that are involved in the theoretical development of the East Asian Community, especially those who are aiming to realize a close cooperation in the financial field.

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