

PECC Finance Forum Conference

Issues and Prospects for Regional Cooperation for Financial Stability and Development

HILTON HAWAIIAN VILLAGE, HONOLULU

AUGUST 11-13, 2002

Day One: Scope for Regional Financial Cooperation among PECC Economies

Session III: Other PECC Economies' Perspectives

Country Perspective Paper: Australia

**PECC Survey of Regional Arrangements
for Financial Cooperation: An Australian Perspective**

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Well-functioning arrangements for economic and financial security are a high priority for Australian policymakers. The PECC Finance Forum is concerned with one aspect of this, regional financial arrangements. It uses a questionnaire to ask individual PECC governments about their views on the current status of regional financial cooperation and the scope for deepening and improving it. This is an important question.

But it is very difficult to answer. No country has a fixed and static view on regional cooperation. Views change as domestic, regional and international circumstances change, and as domestic priorities and strategies for regional and global engagement are reassessed and adapted. It also depends very much on the interlocutor, since politicians may speak differently about these issues from officials, and officials may have different views about these issues and emphasise different features of regional arrangements. In this respect, there is rarely a single view, although there are usually majority views.

And it is very difficult to obtain genuine views because of the degree of intrusion the questions make into what are sensitive diplomatic areas for all governments. It is very hard to ask about government or official views and get - or even to expect to get - straight answers. Governments seldom have an 'Official' policy on most things, including regional engagement. If they do, it is likely to be general and rhetorical. If they do not, officials will generally be reluctant to speak about their thinking and views because they will not want to pre-empt Government decisions, unnecessarily tie themselves down, or cause controversy. This occurs under all systems and is to be expected.

This does not mean that the task is wrong. It is just very hard to answer. In preparing the Australian response, I outline the various approaches and thoughts of policymakers impressionistically. The answers should not be interpreted or used as 'The Official Australian View'.

1. Do you think that PECC Area financial cooperation is desirable or necessary? Is regional financial cooperation necessary or desirable?

Take these questions in reverse order.

Is regional cooperation necessary or desirable?

There is a well-established case for financial cooperation, but there is more debate about whether and how this should be pursued in global or regional forums.

The need for regional financial cooperation depends on the effectiveness and reliability of global financial cooperation, the nature and size of the disturbance the cooperation is directed at addressing, the mechanisms for coordination between global and regional cooperation, and the degree of regional cohesion. Take these in turn:

- The more effective and reliable is global financial cooperation, then the smaller is the need for regional cooperation. A lot of financial resources exist at the global level to assist countries in financial distress, especially through the IMF (including the NAB), and it is natural to look at using established mechanisms before creating new ones. The East Asian financial crises of 1997 and 1998 have shown, however, that the response through global mechanisms may itself have problems at times: it may take a while to mobilise funds for smaller countries, especially if major countries outside the region are less interested; and it may have some

inappropriate conditionality. These problems should be dealt with in the first instance by improving the operations of the IMF. But, because reform of the IMF is such a difficult process, there is scope for seeking complementary regional financial arrangements.

- There is also now some ground for thinking that credible regional financial arrangements may be better suited to preventing contagion than the IMF. The IMF has set up a Contingent Credit Line (CCL) facility which is designed to allow countries with 'sound fundamentals' to sign on to the facility and access finance if they are subject to a contagious speculative attack. No country has signed on because they are concerned about the signalling effects to markets of signing on (it means that policymakers think the country is at risk of speculative attack, even if it is unjustified) and being 'signed off' (a crisis will happen if the IMF says the country is no longer eligible for the facility). But a general regional facility which was available as a crisis-prevention measure when members judged to be 'fundamentally sound' are subject to contagion may provide some confidence, so long as the judgment process is credible.
- The need for regional financial cooperation depends on the nature, size, and spread of the financial crisis.
 - A pure liquidity crisis – say when a country has a temporary foreign currency or maturity mismatch – is probably best dealt with at a bilateral or regional level (and, by its nature, would be unlikely to require conditionality). These sorts of mechanisms are widespread. But it is also pretty hard to imagine a liquidity crisis occurring that did not become a deeper financial crisis.
 - A small localised financial crisis may be better dealt with at the regional level if the regional arrangement can be activated quickly enough and is seen by the financial markets as credible. These two 'ifs' are important. With respect to the second one, the credibility of the regional arrangement will depend on the amount of funds that is available and on the terms and conditions attached to those funds. The bigger and more regionally widespread the crisis, the more likely it is that global mechanisms will be required. The IMF is also probably the best institution to deal with big issues like private-sector involvement, technical assistance, and economic and financial structural adjustment programs.
- Because no one knows at the start whether a crisis is going to be big or small, stay localised or spread, then it is essential to have robust links between regional and global financial cooperation bodies. This does not necessarily mean that regional financial cooperation should be conditional on IMF programs. But it does mean that it is essential to have in place very good communication links and workable mechanisms to shift from a regional to global response mechanism if necessary. Otherwise, a crisis may be made worse.
- The more cohesive the region is, the more effective regional financial cooperation is likely to be. The more willing countries are to cooperate, the more likely it is that a system of regional cooperation will work. The best example is the difference in French and British commitment to maintain EMS bands in 1992; in the presence of substantial speculative pressure, the British caved in but the French resisted fiercely and relied on very substantial German support.

A country's support for regional financial arrangements is also based on wider strategic objectives. If bilateral or regional policy dialogue is weak, for example, supporting regional financial arrangements may be a means to motivate better policy dialogue and surveillance, to the benefit of

national and regional stability. Participation in regional financial arrangements may also meet other particular strategic and security policy objectives.

Is PECC Area financial cooperation is desirable or necessary?

The next question is whether regional cooperation is desirable or necessary in the PECC area. The PECC area itself is very broad and so cooperation within it is more likely to be suited to global forums like the IMF. That said, financial cooperation within parts of the PECC area, such as East Asia, may well be both desirable and necessary.

There is an established record of financial cooperation within East Asia. The ASEAN swaps arrangement has been in place for a few decades (although it has only been used four times). A system of central bank repurchase agreements between some EMEAP economies¹ was put in place in the mid 1990s, and a system of swaps has been set up by ASEAN+3 within the Chiang Mai Initiative (which also boosted the ASEAN swaps agreement). First and second lines of defence were also established in support of three crisis-affected economies in 1997, Thailand, Indonesia and Korea.

Australia has been a consistently strong supporter of these regional financial arrangements. A prosperous and stable East Asia is in Australia's interests, and Australia has consistently shown its willingness and ability to promote stability in the region. For example:

- Australia is a part of the central bank repurchase agreements between some EMEAP economies.
- The then Governor of the Reserve Bank of Australia, Bernie Fraser, proposed an East Asian BIS in 1995.
- Australia contributed US\$1 billion to the financing packages for Thailand, Indonesia and Korea in 1997. Australia and Japan were the only two countries in the region (and the world, for that matter) to contribute to all three packages.

The creation of ASEAN+3 and the CMI swaps arrangement are welcome developments. The CMI is a useful step forward in advancing financial cooperation within East Asia. Two other welcome features of regional financial cooperation in East Asia are that it encourages improved policymaking at the national level and it expands the opportunity for substantive policy dialogue between countries in the region.

2. What do you think about the status of regional financial cooperation? Is it satisfactory or unsatisfactory?

The process of regional financial cooperation is still in its early days and there is scope for much deeper policy dialogue and financial cooperation.

3. Which regional institution best achieves the goal of regional financial cooperation? Why?

Regional cooperation has many dimensions and it is too simplistic to say that one institution can do it all. The important thing is to maintain complementarity and consistency between the different

¹ Executive Meeting of East Asian Pacific (EMEAP) economies include Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand.

institutions and forums, and seek to maximise the advantages that each particular forum offers. A bit of overlap should not be a worry. One of the great advantages of the range of forums that currently exist is that they bring policymakers together in different contexts over a period of time, enabling them to build solid working relationships between themselves and to sort through and address, even if only incrementally, key policy issues of common concern. Some overlap and repetition are not bad things if they help policymakers form a consensus.

In terms of the institutions that are outlined, some comments can be offered about the contribution they make. Australia is not part of ASEAN, ASEAN+3 (and the CMI), or the South East Asian Central Bank Group. ASEAN and ASEAN+3 are the central regional political institutions in East Asia, and play – and will play in the future – a critical role in bringing together very diverse sets of countries, reducing deep strategic and economic tensions between them, and providing a platform for cooperation, harmonisation and integration. This is why Australian ministers and officials have clearly stated their support for ASEAN and ASEAN+3.

Australia does participate in the Manila Framework Group, EMEAP central banks, Four Markets Group and APEC Finance Ministers. All of these groups provide value.

- MFG provides an opportunity for senior finance and central bank officials to discuss recent economic and financial developments. It also brings the United States and the IFIs to the table, which is complementary to East Asia's regional body, ASEAN+3.
- EMEAP is more obscure but it is an important regional central bank forum. It meets at the Governor and Deputy Governor level, and has three very effective working groups on bank supervision, payments systems, and foreign exchange markets. The strength of EMEAP is that it allows officials to deal expertly with technical and broad policy issues but its distance from the political process means that it lacks political clout. It is complementary to the other forms of dialogue in place.
- The Four Markets Meeting brings together finance and central bank officials from the region's four biggest financial markets - Japan, Hong Kong SAR, Singapore and Australia – to discuss financial issues. This is a small specialist group, well targeted to a particular set of issues of common interest. It is complementary to the other forms of dialogue in place.
- The APEC Finance Ministers meetings brings finance ministers from a geographically diverse set of countries to discuss economic and financial policy issues. It provides a useful forum for ministers to dialogue, if not on the floor of the meetings then in the corridors. Finance and central bank officials also meet and dialogue can be useful. The downside of APEC Finance Ministers is the size of the group. APEC Finance Ministers meetings also provide a useful vehicle for training of officials.

4. Please indicate how the relevant institution focuses on preventing future financial crises?

ASEAN+3 and the MFG are the only institutions which focus on preventing future financial crises. ASEAN+3 provides certain funds under the CMI bilateral swaps arrangement and provides some surveillance through its policy dialogue processes. ASEAN+3 does not have monitoring criteria. MFG is a surveillance group rather than a financing group. It does not have monitoring criteria except in so far as they are applied by the IFIs (IMF, IBRD and ADB).

5. Does the institution monitor economic performance in member countries in a regular and systematic way?

There is progress towards this.

6. Which member countries provide leadership in each institution.

Generally speaking, countries with more resources and experience – like those also actively involved in global forums like the FSF and G-20 – and fewer domestic problems tend to be those that are in the best position to provide leadership. In some instances, inter-agency rivalry within a particular country has reduced the effectiveness of a country's leadership.

7. Can you elaborate on the roles played by the central bank and finance ministry representative?

The central bank and finance ministry in Australia cooperate closely in international economic and financial forums. Officials have frequent contact and typically assume common positions on issues, especially in meetings in which both are present. The Treasury and the Reserve Bank are members of the International Economic Policy Group, which is chaired by the Department of Prime Minister and Cabinet and also includes the Department of Foreign Affairs and Trade, AusAID, and the Office of National Assessments.

The finance ministry official tends to lead in APEC Finance Ministers forums because the coverage of these meetings is typically broader than the responsibilities/expertise of the central bank, but both agencies participate freely in APEC Finance, as they do in MFG and Four Markets Meetings.

8. Given the spectrum of 'degrees of cooperation', how would you rate the level of cooperation in each institution?

Frankly, it is all much the same in each of these forums. All governments always look to protect or advance their interests in a forum. They will seek to cooperate, coordinate or integrate if they think that, on balance, given the risks involved, such action will protect or advance their interests. The focus on net interests means that they are prepared to make trade-offs, but they will only give something up if they think there are outweighing gains.

9. Please give positive and negative examples of cooperation.

Positive examples of cooperation include:

- Network of central bank swaps agreements in the mid 1990s. This was an outcome of cooperation between some EMEAP central banks.
- First line of defence arrangements in the East Asian financial crisis. This was the outcome of meetings between countries in the East Asian region (including Australia and New Zealand). It was an important practical regional response to the Thai crisis.
- The CMI swaps agreement, which evolved out of ASEAN+3. The CMI has yet to prove its worth but it does put an important set of issues on the table.

Negative examples of cooperation include:

- Second line of defence in the East Asian crisis. This was an outcome of meetings between countries in the East Asian region (including Australia) and the United States and Canada. It was ineffectual and was a way for certain countries to avoid making a commitment for funding.
- The chauvinistic or emotional elements in ASEAN+3 which exclude countries in the East Asian region, like Australia and New Zealand, from regional cooperation forums. Australia has a long history of regional engagement and financial support and it is deeply economically and socially integrated into East Asia, but it is being excluded from new forums (like ASEM, ASEAN+3 and ACD) for political reasons.

10. What attention is paid in each regional institution to linkages between regional and global financial initiatives?

The CMI, MFG and APEC Finance Ministers meetings all have a role of some sort for the IMF, and, for the latter two forums, the IBRD and ADB. While EMEAP does not usually include the IMF in its officials meetings, it will on some occasions. EMEAP working groups work closely with the IMF, BIS and other institutions. The Four Markets Meeting is member-countries only.

11. Do you think such linkages are needed?

It depends on the forum and the issue.

If it is a matter for which the IMF or other IFI can make a contribution, then it is appropriate that the IFI(s) be included. There is no reason why the IMF has to be a part of everything that is done by everyone. But it is also an important international institution and can bring a lot of expertise to issues. Despite its problems, there is also no reason to exclude it from dialogue and cooperation at a regional level. It is after all, partly owned by governments in the East Asian region and governments have the right to use the range of services the IMF can provide.

A regional response may be the way to go for a small or localised financial crisis, as discussed above, but the risk is always there that the crisis will grow and spread and may become too much for the regional mechanism to cope with. This means that regional responses need to have clear and robust communication links with the IMF and well-thought-out mechanisms for involving the IMF if the need arises (and do so in a way which does not make the crisis worse).

In dealing with financial crises, there are also crucial issues - like private-sector involvement, technical assistance, and post-crisis structural adjustment – in which the IMF has a comparative advantage. Even if the official financial support elements of resolving a crisis are dealt with regionally, it may be appropriate to involve global institutions in other aspects of crisis resolution.

12. What does your ministry consider are the priority goals for each of these regional institutions?

The overriding policy goal is good economic management in the nations of East Asia, harnessing regional cooperation and integration as ways to achieve this.

13. Do you think any of these institutions should be reformed?

There is always scope for improving policy dialogue and financial cooperation. Policymakers are working constructively together to this end.

The membership of ASEAN+3 is too narrow in the sense that it excludes Australia and New Zealand, both of which are deeply economically, financially and socially integrated with East Asia. ASEAN+3 has many facets. It is a political institution directed to managing the various and complex competing national interests that exist within East Asia, integrating economies in East Asia, and representing and advancing the region's interests globally. As a member of the region, Australia has a strong and natural interest in these developments, and can both contribute to them as well as benefit from the experience of, and interaction with, other nations in the East Asian region.

An important area of activity within ASEAN+3 is financial cooperation, embodied within the CMI. Australia has long been active in East Asian financial cooperation and could make a contribution to the CMI swap arrangements. An important issue for ASEAN+3 in extending participation in CMI to other countries is the capacity of those countries to make a substantial financial contribution. The ability to make a financial contribution is usually judged by the size of a country's foreign exchange reserves, but this is too narrow. The right criterion is a country's financial capacity. While Australia does not have large foreign exchange reserves, it has a large and undoubted capacity to borrow foreign currency (as, indeed, it has to borrow internationally in its own currency). From this perspective, Australia has substantial capacity.

As said above, concerns about overlap should not be overstated. Some overlap is a good thing because it provides more opportunity for developing familiarity between officials and forming consensus.

14. What reforms are needed to move towards closer monetary cooperation to lay the basis for reduced currency volatility in the region and, in the longer term, for a common currency?

The conditions for closer monetary cooperation and a common currency are strict. At the heart of it, they require unwavering political and institutional commitment for the system to work. While East Asian nations have shown some important preliminary and symbolic commitments along these lines, there is no consensus on closer monetary cooperation or forming a common currency.