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*Issues and Prospects for Regional Cooperation for Financial Stability and Development*

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**Day One: Scope for Regional Financial Cooperation among PECC Economies**

**Country Paper:  
The Malaysian Perspective  
and Views of ASEAN Countries**

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## **I. Introduction**

The Asian financial crisis has added impetus to regional financial co-operation in Asia. It should be noted, however, that the history of Asian financial co-operation actually began much earlier, in the 1960s. Over the last four decades, financial co-operation in this region has progressed steadily and quietly. The regional financial crisis has prompted renewed impetus to strengthen financial co-operation as the region sought ways to avoid future crises. Given the diversity and different levels of economic development, the road to closer regional financial co-operation in Asia will, of necessity take time to materialise. What is important, however, is to develop a clear vision for the future direction of Asian financial co-operation, that is shared by all its members.

The paper has been organised as follows: Section II gives an evaluation of the various existing regional financial co-operation in ASEAN. Section III contains a brief overview of Malaysia's role in regional co-operation, while Section IV outlines Malaysia's views on the way forward for regional financial co-operation, particularly in terms of surveillance, co-operation on exchange rate arrangements and development of the Asian bond market. The paper concludes with Section V. Where relevant, the paper includes comments/responses to ideas raised in the papers from Singapore and Thailand.

## **II. Evaluation of Regional Financial Co-operation in ASEAN**

Economic literature on ASEAN regional co-operation generally concludes that financial co-operation in ASEAN occurred rather late and trailed far behind co-operation in trade and defense, in terms of both substance and depth. What is not well documented is that financial co-operation in ASEAN has been active since the 1960s. Much of these co-operative efforts have been outside the ASEAN framework. In 1972, the Southeast Asian Central Banks Research and Training Centre (SEACEN) was formally set up in Malaysia. The founding members of this organisation were the five original ASEAN members and Sri Lanka, Nepal and Myanmar. Vietnam, Laos and Cambodia have been participating as observers since the 1960s (Korea, Taiwan and Mongolia joined in the 1990s). Although the SEACEN Centre was established in 1972, the Governors of SEACEN central banks have been

meeting annually to discuss economic and financial developments in member economies since 1967.

That SEACEN was not viewed as a significant regional financial development was mainly because it focused on central banking issues and capacity building in the financial sector of member states. SEACEN provided intensive training in bank supervision and macroeconomic policy formulation. To date, SEACEN has developed a reputation for a strong curriculum in bank supervision. Following the Mexican crisis, this recognition was accorded by APEC when it endorsed proposals to use SEACEN as the base for extension of training of supervisors for the APEC region.

In the ASEAN framework, regional financial cooperation started in 1977 with the ASEAN Swap Arrangement (ASA) among the central banks of Indonesia, Malaysia, the Philippines, Thailand and the Monetary Authority of Singapore. The purpose of the ASA was to provide short-term liquidity support to member countries facing temporary balance of payment problems. Since then, the ASA has been modified and more recently expanded in terms of amount as well as members, to include the six new ASEAN members.

Financial co-operation in insurance also started early. More recently, the ASEAN Insurance Regulators Meetings have been held since 1998. Recent major insurance initiatives in ASEAN insurance co-operation include the establishment of the ASEAN Insurance Training and Research Institute, observance of the International Association of Insurance Supervisors' "Insurance Core Principles", the implementation of Protocol 5 on the ASEAN Scheme of Compulsory Motor Vehicle Insurance, and the adoption of the Unified Forms of Statistics.

### **III. Malaysia's Role in Regional Co-operation**

Malaysia remains a strong proponent of regional co-operation. Early involvement in co-operation among central banks in the region expanded to providing financial support during the Asian crisis and active participation in more regional forums after the crisis.

Areas of cooperation where Malaysia has provided financial support and commitment included the following (details in Appendix 1):

- (i) Commitment to the New Arrangements to Borrow (NAB) amounts to SDR340 million (1% of the total size of SDR340 billion);
- (ii) Commitments under the new ASEAN Swap Arrangement (ASA) of US\$150 million;
- (iii) A two-way swap with Korea under the Chiang Mai Initiative (CMI) for US\$1 billion whereby Malaysia undertakes to provide US\$1 billion in USD to Korea for the equivalent of Korean Won. (The swap will be reversed to USD for ringgit when Malaysia requires short-term financial assistance);
- (iv) Malaysia provided financial support to Thailand under the financial package involving eight countries, the World Bank, the Asian Development Bank and the Eximbank of Japan; and
- (v) Malaysia committed a similar financial support to the Indonesian package but this was not activated.

In terms of other areas of co-operation, Malaysia's current involvement could be categorised into two distinct co-operative efforts: strengthening regional surveillance and building capacity in the regional financial sectors to develop resilience to external shocks.

**(i) Regional Surveillance**

Regional surveillance received renewed interest following the Asian crisis. In this area of co-operation, the active role by Malaysia has been evident on two fronts: the finance process and the central bank process.

## **The Finance Process**

The finance process in existing regional forums have generally been established with the purpose of further developing regional financial and monetary co-operation among member countries. The process typically involves meetings at the Deputies and Finance Ministers levels to exchange views on recent economic and financial developments of their respective economies, regionally and globally. There are also policy dialogue, co-operation in terms of surveillance and peer review as well as the implementation of capacity building initiatives. In most cases, the finance process involves the participation of both finance ministry and central bank officials. Membership of the forums range from those of the ASEAN and North East Asian countries (China, Japan and Korea) to include Australia, Canada, New Zealand, the United States and European countries.

Although the ASEAN Foreign and Trade Ministers have been meeting since the 1960s, the first ASEAN Finance Ministers Meeting (AFMM) was only convened in Phuket, Thailand, in February 1997 (ironically only a few months before the outbreak of the crisis). The most significant finance process for regional surveillance is the ASEAN and the ASEAN+3 framework. Under the ASEAN finance process, meetings are held among the Finance Ministers as well as the Finance and Central Bank Deputies. The key area of financial co-operation under ASEAN is regional surveillance and peer review, conducted generally on an informal basis. The peer review process is complementary to the surveillance exercise by the International Monetary Fund (IMF).

Under the ASEAN+3 (that is, ASEAN plus China, Japan and Korea) finance process, Finance Ministers and their Deputies meet on a regular basis to intensify monetary and financial co-operation in the region. Substantial progress has already been made by the ASEAN+3 finance process in terms of establishing arrangements for short-term financing, surveillance, policy dialogue and exchange of information. In the area of regional financing arrangements, the most significant development is the launch of the CMI in May 2000. The CMI marks a particularly important step towards promoting a regional self-help and support arrangement among the ASEAN+3 countries.

The ASEAN+3 finance process also places great importance on surveillance and peer review arrangements. To this end, a Study Group that is jointly chaired by Malaysia and Japan has been formed to examine ways of enhancing the regional surveillance process to complement the CMI. Following recommendations of the Study Group, measures have already been undertaken to enhance the surveillance process. In addition, work is also underway to develop a prototype of an early warning system. Further, the exchange of information on short-term capital flows between member countries is also taking place on a bilateral and voluntary basis.

Other group meetings under the finance umbrella are the APEC, ASEM and the Manila Framework Group (MFG) meetings. In the MFG, work on regional surveillance are being supplemented by a regional financing initiative. While the intent is for the group to provide financial assistance, unlike the CMI, there is no pre-determined amount of financing, only a commitment to lend support when the need arises.

### **The Central Bank process**

The central bank process under the regional forums were formed generally to facilitate frank exchange of views on issues that fall under the purview of central banks and monetary authorities. Generally, meetings are held among central bank officials to discuss issues of mutual interest pertaining to monetary and exchange rate policy as well as the financial and capital markets. Other co-operation initiatives also include those relating to surveillance and peer review. In addition, there are also initiatives on the provision of technical assistance and training. Membership of these forums extend from countries in the East Asian region to others in Central Asia, such as Nepal and Mongolia, as well as the Pacific region (Australia and New Zealand).

Similar to the finance process, discussions at the central bank level concentrate on peer review and policy dialogues. Unlike the finance process, however, there is considerable co-operation at the technical level which has helped build capacity among member central banks. Technical co-operation exists in both ASEAN and The Executives' Meeting of East Asia and Pacific Central Banks

(EMEAP). Work on developing an Asian bond market as well as those on exchange rate issues, banking supervision, and payments and settlement systems have made significant progress. There is also information sharing of capital flows data among members as part of the central bank efforts to deepen the surveillance framework.

The central bank process involves those under the ASEAN, ASEAN+3 umbrella, the EMEAP and the SEACEN process. More recently, the Asian Consultative Council (ACC) was established in 2001 by the Bank for International Settlements (BIS) to provide a vehicle for communication between the Asia-Pacific members of the BIS and the Board and Management of the BIS, particularly on issues concerning banking regulation and supervision, market functioning, and payment and settlement systems.

## **(ii) Capacity Building in Asia to Build Economic Resilience**

Regional surveillance is an effective mechanism to exert peer pressure to promote sound policies. Developing sound policies, however, rests critically on the requisite skills and capabilities of financial regulators and policy makers. In developing this important pre-requisite for effective macroeconomic management, regional co-operation should also focus on training to build domestic capacity in each country and, hence, strengthen regional resilience.

Malaysia accords high priority to this area of training for enhancement of domestic capacity in developing stronger and more resilient financial sectors in Asian economies. In this area, Malaysia has spearheaded changes in SEACEN. The traditional focus on bank supervision has expanded to incorporate the broader perspectives of financial stability and restructuring of distressed financial systems. As Asian financial sectors become increasingly integrated into the global economy, SEACEN has also extended its collaboration with not only the IMF and the World Bank but to also work together with the BIS, APEC, ADB and Japan. Closer and wider collaboration has facilitated its work in ensuring that training of regulators and surveillance personnel are able to cope with the rapid changes in the global financial markets.

Within EMEAP, too, the objective of facilitating domestic capacity building is effected through joint studies and research as well as participation in more globally-oriented payments and settlement systems. In both SEACEN and EMEAP, effective research in foreign exchange issues has also helped build capacity in the formulation of monetary and exchange rate policies, as well as policies in building economic resilience to external developments.

#### **IV. Regional Financial Co-operation: The Way Forward**

Going forward, there is much to be gained from more concerted efforts to strengthen regional financial co-operation within Asia. ASEAN will always remain an important regional forum for the emerging Southeast Asian economies. Strengthened co-operation within ASEAN will see greater liberalisation of the “newer” economies as they expand and integrate more into the global economy. As the income and “openness” gap narrows among all ASEAN economies, it should broaden the scope for regional co-operation.

The issues facing strengthened co-operation spans three fundamental areas. First, is the need for a greater focus. ASEAN should determine the desired future direction and the timetable. There should be a kind of master plan—an end game—that would take ASEAN forward. Options include taking the view that regional co-operation is a Group effort to make that quantum leap to achieve a higher per capita income and quality of life for its peoples. The idea is that regional co-operation will enhance the incomes of the Group without adversely affecting incomes of any individual state. This, of course, entails co-operation and a willingness to abandon the concept of the “winner takes all”. Second, is the issue of political commitment. In the history of ASEAN, there are many aspects of co-operation in finance that have made significant progress without explicit political support. As we go forward, deepening of regional co-operation could do well with more explicit political commitment. More important would be the commitment to achieve some targets within a specific time period. Third, in deciding regional co-operative strategies, there would be areas in which ASEAN can proceed as a bloc. There are also other aspects of regional co-operation in which greater strength would emanate if the grouping encompasses the important and strategic economies of East Asia.



Where a wider grouping is more advantageous, the ASEAN+3 is the ideal regional forum for several reasons. Firstly, the membership of the ASEAN+3 is not too large yet adequate to provide a balanced representation of ASEAN and the North East Asian countries of China, Japan and Korea. Secondly, the ASEAN+3 countries already possess many of the micro-foundations for greater financial co-operation. These include a high level of intra-regional trade in Asia. China, for example, is emerging as a new engine of growth within the region. East Asian exports to China have doubled in the past decade to about 12% of the region's total trade. In the past two years, Korea has exported more to China than to Japan. Intra-regional trade now accounts for almost half of Asia's total trade, compared with just a fifth a decade ago. There exists, therefore, significant potential mutual gains from intra-regional trade and investment flows. Thirdly, and perhaps most importantly, the ASEAN+3 forum has set in place the foundations for greater financial co-operation by establishing the regional financing arrangement under the CMI and undertaking work on surveillance to enhance economic review and the policy dialogue process. In particular, such co-operation are indicative steps towards creating a regional liquidity fund and provide the purposeful basis for further co-operation towards regional mechanisms for ensuring that Asia contributes towards global stability.

Another aspect of regional co-operation in ASEAN is that the approach to strengthening regional financial co-operation would need to be a gradual process. Efforts are already underway to implement confidence-building measures, namely, through regular dialogues among senior officials and Ministers. A gradual approach would ensure that the structure of future co-operative arrangements would be aligned with countries' specific interests and needs.

Looking ahead, the future direction of regional financial co-operation in Asia could build on the momentum of the CMI to realise a Regional Self-Help and Surveillance Mechanism:

- Currently, the CMI is envisaged to be "complementary and supplementary to the IMF's financing facilities". Disbursement of funds beyond 10% of the swap facilities under the CMI can only be made in association with an IMF programme.

The current link between the CMI with IMF conditionality is to address moral hazard concerns as well as the absence of an effective regional surveillance mechanism for the CMI. The work by the ASEAN+3 Study Group on ways of enhancing the regional surveillance process is important in ensuring the success of the CMI as an independent regional self-help mechanism.

- The appropriate surveillance mechanism would also facilitate prompt identification of conditionalities to be applied for the disbursement of financing assistance, thus allowing for quick disbursement of funds. It would also address the concern that a regional financing arrangement would result in "soft conditionalities" and enhance the credibility of the CMI.
- As the process of regional financial co-operation advances further, it would be desirable for the CMI to assume the role as the primary source of liquidity support, with the IMF providing complementary support.
- The CMI could serve as a premise for the creation of a regional self-help mechanism providing the first line of defence in crisis prevention and management. Institutionalising this arrangement would create a more structured approach for all existing financial co-operation in crisis prevention (surveillance), crisis resolution (liquidity support) as well as develop regional financial markets (institution and capacity building). This institution would complement work at the IMF. It would also be consistent with institutional arrangements in other regions. For example, Europe has the GAB and the NAB, while Latin America has the US exchange funds.

Finally, on the coverage of potential areas for strengthening regional co-operation, priority should be accorded to the following:

**(i) Surveillance**

The implementation of IMF surveillance includes bilateral and global surveillance (country assessments under Article IV and reports through the World Economic Outlook and the six-weekly Board discussions on the World Economic and

Financial Market Developments). Unlike bilateral surveillance, multilateral surveillance tends to concentrate on forecasting and analysis rather than policy prescription, which in turn provides the basis for discussion by countries in multilateral forums.

The effectiveness of IMF surveillance has been a subject of much debate since the Mexican crisis of late 1994 and the financial crises in Asia. In response, the IMF has implemented several measures to strengthen its surveillance function with a view to reduce the likelihood or severity of future crises.

Overall, the thrust of IMF surveillance has been to encourage countries to adopt international standards and codes, to enhance economic management and risk analysis. At the same time, the IMF has also increased its participation at international and regional fora, including in Asia to facilitate the conduct of regional surveillance in regional fora including APEC, ASEAN, EMEAP, MFG and SEACEN. Concrete measures to strengthen regional surveillance in the region have been implemented via the ACBF and the ASEAN and ASEAN+3 Finance Process.

However, the recent crises in Latin America suggests that IMF surveillance, while important, is no guarantee for regional financial stability. There is, therefore, a need for stronger regional surveillance mechanisms to complement the IMF's global surveillance. At this juncture, it is widely recognised that the effectiveness of regional surveillance through the finance and central bank processes could be enhanced. Effective surveillance, however, depends on all members being "comfortable" with each other. An environment of mutual understanding, trust and respect must develop for officials to be candid and open in exchanging views on regional issues of concern, including accepting critiques of each others' policies and their implications on the region in general and on individual economies in particular.

That said, the creation of a network of Bilateral Swap Arrangements (BSAs) under the CMI provides a strong motivation for the AFMM+3 to pay closer attention to regional surveillance issues. The AFMM+3 members would now have a strong incentive to point out policy concerns and risks in member economies, and suggest

or even exert peer pressure on members to implement pre-emptive, remedial policies to avert future crises in the region. The aim, of course, would be to avoid the need to activate the BSAs that are in place. In the process, this would enhance regional surveillance and the role of the CMI in crisis prevention.

The importance of regional surveillance as a complement to the CMI's role in providing short-term financial assistance in the event of a crisis is well recognized in ASEAN+3 countries. To this end, Malaysia presented proposals, including the creation of an "Group of Eminent Persons" (GEP) to provide an independent and objective assessment of regional issues to the AFMM+3. Other options include the creation of a dedicated ASEAN+3 surveillance secretariat as well as the possibility of "out-sourcing" the secretariat function (technical support to the GEP) to a regional financial organisation such as the ADBI. While the debate continues on the relative merits of alternative proposals on surveillance in ASEAN+3, it is important to note that the overall objective remains clear, namely, to develop an effective and credible regional surveillance mechanism that will complement the regional financing facility under the CMI.

The main obstacles to enhancing surveillance in the region remain concerns over independent assessments of country and regional policies. As pointed out by Thailand, the concept of a GEP would indeed contribute to building the intellectual capacity and enhancing competency in surveillance within ASEAN. The Malaysian proposal involved ideas and criteria for selection of the GEP. The issue of technical support was also considered. Unfortunately, the concerns over third party reviews by some quarters derailed constructive discussions of an appropriate surveillance mechanism. ASEAN, nevertheless, agreed that the surveillance mechanism must indeed be enhanced. Deepening surveillance is not meant for ASEAN to be more intrusive of national policies, but rather to provide adequate and in-depth analysis of national and regional developments. Success of surveillance could be measured by outcomes whereby ASEAN officials emerge from surveillance discussions with the recognition that policies would need to be improved/reviewed.

The paper by Thailand has expanded further on Alternative B for the technical support to the GEP as contained in the proposal to the ASEAN+3 that was made in Myanmar (that is, establishing the support unit at the ASEAN Secretariat or an existing regional research institution). The idea of pulling together research institutions and top policy researchers in ASEAN+3 should make the Alternative B proposal more acceptable.

**(ii) Co-operation on the Exchange Rate Front**

Enhanced surveillance would help economies manage currency volatility. It would not reduce this volatility. Management of exchange rate volatility, even if effective, would be at a cost. Moving towards greater co-operation in exchange rate issues would, therefore, address this concern. It would also be a good progression from providing liquidity support under the CMI.

The Thai paper questions whether decisions are required on the choice of exchange rate regimes before embarking on co-operation in exchange rate co-ordination. Concepts on currency unions and a single currency for ASEAN (or East Asia) have been proposed. As suggested in the Singapore paper, some semblance of currency union exists between Malaysia, Singapore and Brunei (the system between Malaysia and Singapore was more of maintaining the exchange rate parity between the ringgit and the Singapore dollar). Structural changes did not make it economically viable to maintain this parity. Malaysia finally abandoned all efforts to maintain any level of exchange rate parity with the Singapore dollar. The ringgit was allowed to freely float against the Singapore dollar towards end-1984.

At this juncture, there would be scepticism on the viability of common currency arrangements in Asia. The ADB views this as a vision for the next 30 years. Of importance to ASEAN and the region is exchange rate stability to promote trade and investment as well as resilience of the domestic economies. Singapore and Brunei enjoyed this stability through the currency union. For East Asia, options to promote currency stability rather than any particular exchange rate arrangement should be studied and explored.

As indicated earlier, it would first be necessary to develop a strategy on the direction for future co-operation. Meanwhile, research on possible modes of promoting exchange rate stability should continue. Various proposals have been floated:

- the three-currency basket peg;
- a parallel currency arrangement; and
- an East Asian Dollar standard.

In undertaking studies as complex as exchange rate co-ordination issues, existence of institutionalised technical support would be critical. In the European model, the network of both formal and informal but technically-oriented institutions helped undertake these complex research work to support regional co-operative efforts. In ASEAN+3, the institutional support for the work on regional surveillance could also provide the structural support for work to progress in the exchange rate area. These institutions would facilitate the exchange of information between relevant parties. They would enable difficult issues to be thoroughly analysed and subjected to rigorous research by specially created technical bodies. The findings could subsequently be channelled to the respective political forums for scrutiny and debate prior to seeking political support. In other words, as was the case in Europe, having appropriate institutional framework would be critical in smoothing the way towards deepening regional co-operation.

### **(iii) Development of the Asian Bond Market**

The opportunities for closer collaboration to maximise the comparative advantages in individual ASEAN+3 countries are self-evident. The high savings rate in ASEAN+3 countries also suggests that there is potential for an Asian bond market to be developed to recycle such savings to finance productive activities in ASEAN+3 countries. Work in this area has started in ASEAN as well as EMEAP. In terms of benefits, an Asian regional bond market augurs well for the region. It would not only create efficiency in mobilisation of savings but also offer greater diversification of instruments and risks to Asian investors. It would also deepen Asian financial markets and allow for better balance in the flow of financial resources from Asia to

Europe and the United States. Asia could also contribute effectively to the adjustment of the global economy.

## **V. Conclusion**

The benefits to regional co-operation in Asia would be harnessed through having a clearer vision on the direction of co-operation. While a gradual approach is necessary, given the diversity of national interests amidst the different levels of economic progress, a timeframe on meeting specific milestones or targets would facilitate a more co-ordinated work programme.

Institutional building is important to ensure work progresses in terms of both depth and coverage, as well as facilitate research that are prerequisites to success of policy co-ordination in Asia, especially in the monetary and exchange rate areas.

The CMI initiative has set up the basis for regional support and provides a strong peer pressure for enhancing surveillance to avoid moral hazard from liquidity support. Enhancing surveillance in turn promotes regional stability. But for surveillance to be effective, there is a need to overcome undue concerns over third party reviews. Further work in developing mechanisms for the GEP concept supported by a technical group (EARFA, as in the Thai paper) should aim at gaining confidence of Asian members. This institutional support to make regional surveillance more effective would also form the structural support for research and other work necessary to further co-operation in the monetary, exchange rate and development of Asian financial markets.