

# Financial Cooperation and Integration in Pacific Asia: The Role of Multilateral and Regional Organisations

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## Overview

Whereas in recent years most studies on the regional cooperation in Pacific Asia were devoted to matters of the so-called “real economy”, since the East Asian financial crisis of 1997/98 set in, interest in monetary and financial matters has immensely increased. This paper is about the question whether cooperation on financial matters is primarily a *multilateral* issue, or whether there is some scope for *regional* action<sup>1</sup>. In answering this question, it is important to discuss under which institutional frameworks such cooperation could - and does - take place.

The paper is organised as follows: In the first section, we will discuss experiences made during the Asian financial crisis on whether apart from multilateral international organisations (MIOs) like IMF and World Bank, regional international organisations (RIOs) played a role. We will do this by analysing three principal aspects:

- Pre-crisis schemes aimed at the financial sector
- Crisis management and immediate reaction (in particular, agreements with the IMF)
- Follow-up, mitigation of effects

This will lead us in section 2 to discuss the principal areas for IO activity in financial cooperation:

- Regional surveillance of financial system reform
- (Additional) financial assistance scheme
- Technical Assistance for banking reform and supervision, management of currency policy, etc.
- Analytical capability.

We do not intend to explicitly discuss currency cooperation here. The Asian area clearly seems to be decades away from anything similar to European currency cooperation and unification. The question of an optimal currency policy (currency board, peg, floating and their relative merits) needs a more technical analysis of the mechanisms involved (see the contributions in ADB Institute (ed.) 1998 and some remarks by Estanislao in this book) than would be sensible and possible for this paper, which is concerned with institutional issues.

Discussing the areas of possible policy activity, we will have the following considerations in mind:

- the economic case for (and against) IO involvement,
- the case for regional (as opposed to multilateral) schemes,
- the political economy of existing or potential IO schemes in this context,

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\* This paper covers events up to the conference. Therefore, developments like the Hanoi declaration of ASEAN or the appointment of a new dean of the ADB Institute with Japanese nationality are not treated here. The author gratefully acknowledges helpful remarks from the participants of the conference.

<sup>1</sup> In this paper, “multilateral” is used as the opposite of “regional”. In this sense, the ADB is *not* a multilateral institution in terms of the terminology used here.

- paying particular attention to the role of Japan and of Japanese actors (bureaucracy, politicians, etc.).

Put in a different way, section 1 intends to do a positive analysis of which IOs - either on a multilateral or on a global level - did what, whereas in section 2 we intend a normative analysis (while explicating the criteria used), taking economic rationality as a point of departure.

## **1. The Asian financial crisis and the role of IOs - positive analysis**

It is almost impossible these days to start any discussion on financial integration and cooperation in Pacific Asia without reference to the 1997/98 crisis. It needs to be discussed what happened during the crisis, what went wrong, what IOs have done and what they might have done or should have been doing. However, this is not the place to attempt a careful post-hoc analysis of the crisis. Rather, we will concentrate on the contribution (or lack of contribution) of IOs.

Three phases can be distinguished:

1. Pre-crisis schemes aimed at the financial sector
2. Crisis management and immediate reaction (in particular, agreements with the IMF)
3. Follow-up, mitigation of effects

### *Pre-crisis schemes aimed at the financial sector*

Although there are different opinions on the origins of the 1997/98 Asian financial crisis, it is usually accepted that an important point of departure for any explanation are the increasing trade deficits of several East and Southeast Asian countries since about 1995, accompanied by - in some cases - even more significant net capital imports. Relying on exchange rate regimes with currencies pegged to the US Dollar for many years, international investors, including banks, were confident in investing in the seemingly invincible “tiger economies”. Indeed, a vicious circle was involved: while foreign capital kept pouring in, the Asian governments tried to sterilize its impact on the money supply by driving up interest rates. This, however, rather strengthened belief in the breath of the upturn in Pacific Asia, and international capital was even more attracted by the high interest rates - particularly, as US and Japanese interest rates were kept disappointingly low from an investor’s perspective. Of course, not only international lenders took part in this game, but potential debtors in Asia also played their part in making this capital pump keep on running, not to mention deliberate government moves to make the inflow of low interest dollars even easier, e. g. through the notorious Thai International Financing Facility.

This circular causation of a continuing upturn - despite of the current accounts pointing to some upcoming problems - critically depended on an appraisal of investment in Asia to be prudent and promising. Doubts were being raised, though. Whereas with respect to Thailand it was slowly realised that a lot of investment only fueled the real estate and financial assets boom (“bubble”), not being employed in productive endeavours, for other countries the prudence of debtors was being challenged. For Indonesia, incidences of crony capitalism were raised, and for Korea, the spider-like spread of the *chaebol* company groups was being questioned. Despite these differences, there is the common feature that “security valves” in the financial system were neglected in almost all those

countries: no clearly enforced bankruptcy laws, no strict supervision of indebtedness and financial soundness, not even transparent information on basic status and performance indicators of the financial systems. For instance, only rather belatedly it became obvious how much capital since 1995/96 was imported on a short-term basis, while often being employed in long-term projects, with the need of frequent roll-over agreements under - hopefully - favourable terms.

In July 1997, a first speculative wave hit Southeast Asia, whereas in autumn, a later wave hit Korea. As for the later wave, the fear of regional contagion was quite strong and important. As Southeast Asian currencies were devalued significantly, it became ever more unlikely that (other) East Asian countries with their competing product ranges could uphold their exchange rate levels, because that would have implied losing price competitiveness on an unprecedented scale with little scope for counterbalancing its effects.

As for the role of IOs, it seems to be almost universally felt that RIOs were almost invisible in the antecedents of the crisis, whereas MIOs played a role, but were rather unable to prevent the crisis. While this general impression is not misleading, one should have a somewhat closer look at the details.

As for the MIOs, a first reproach to be found in much of the literature concerns the lack of warning signals given. The obvious candidate for who should have functioned as a signalling device is the IMF with its Article IV consultations. Several authors have shown that in its publications and statements leading up to the crisis, the IMF has not fulfilled such expectations which the global public may have held:

“The Fund maintains it was warning Thailand over a year ago [i. e., compared to January 1998; W.P.]. But its December 1996 report on that country raises no suspicions; and its 1997 Annual Report does not find fault with Thai or Korean macroeconomic management. In the most recent IMF report on International Capital Markets, released at the Bank/Fund Annual Meeting in Hong Kong in September 1997, any warnings of possible contagion or even backward-looking analysis were conspicuously absent. Only five pages out of 265 were devoted to the Asian currency crisis” (Ito/Portes 1998, p. 1).

A second point concerns the lessons learned from earlier financial crises, particularly from the 1995 Mexican Peso crisis. During that event, it was also noticed that information on national financial systems was too scarce, untimely and unreliable. The IMF did indeed start a campaign to raise the quality of supplied data, particularly by means of setting up and promoting an advanced data dissemination standard, but participation was voluntary and no sanctions or other convincing “incentives” were involved.

It is frequently overlooked that another institution did take care of an important aspect of international financial crises, namely the regulation of national financial systems and their transparency. In September 1997, the Basle Committee on Banking Supervision<sup>2</sup> issued the so-called Basle Core Principles for Effective Banking Supervision. An earlier version had been prepared by April 1997, well before the crisis started. In terms of its contents,

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<sup>2</sup> The Basle Committee on Banking Supervision was set up in 1975 by the central bank governors of the Group of Ten countries, namely Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom and the United States. The secretariat is located at the Bank for International Settlements (BIS) in Basle, Switzerland.

“The Principles represent the basic elements of an effective supervisory system. They are comprehensive in their coverage, addressing the preconditions for effective banking supervision, licensing and structure, prudential regulations and requirements, methods of ongoing banking supervision, information requirements, formal powers of supervisors and cross-border banking.” (BIS 1997).

The report contains timely - and yet belated - warnings about unhealthy capital flows into the emerging economies. While in several respects the Principles may not go far enough, they do constitute a major step towards transparency and reform of national financial systems, developed by a multilateral institution. Incidentally, East Asian economies were involved in this process. While the western-dominated Group of Ten endorsed the report and its conclusions, the “document has been prepared in a group containing representatives from the Basle Committee and from Chile, *China*, the Czech Republic, *Hong Kong*, Mexico, Russia and *Thailand*. Nine other countries (Argentina, Brazil, Hungary, India, *Indonesia*, *Korea*, *Malaysia*, Poland and *Singapore*) were also closely associated with the work” (BIS 1997; emphasis by W. P.).

As for regional cooperation, despite the frequent suggestion that neighbours know best about issues in the region and have the biggest incentive to rectify problems in their own area, efforts to preempt the upcoming crisis were quite inconspicuous. Nevertheless, one should mention at least three areas of action:

Firstly, EMEAP, the Executives’ Meeting of East Asia and Pacific Central Banks, had been founded in 1991 upon Japanese initiative<sup>3</sup>. In its 1996 Governors’ meeting<sup>4</sup>, EMEAS decided to take up three issues in the form of working and study groups, among them “banking supervision”. The Governors are mainly (only) concerned with issues of upgrading their expertise through sharing, though. The item is deliberately termed a Study Group, not a Working Group, and the statement lacks any sense of urgency or imminent importance (BoJ 1996).

On a different level, several monetary authorities of Pacific Asian economies have started since about late 1995 to sign bilateral repurchase (repo) agreements. Such an agreement enables a country to exchange its US dollar Treasury securities for US dollars held by another central bank up to a certain limit. Such dollars can then be used to defend one’s own currency. It has been suggested that interest in such agreements rose when regional central banks came to see the possibility of depreciation, in which case one may consider interventions in terms of supporting one’s currency by selling dollars (Moreno 1997). Repo agreements could thus be understood as preparations for eventually critical situations. However, one should not exaggerate the “regional cooperation” aspect of such deals. After all, repo agreements and currency swap agreements are standard procedure among the industrialised economies in the G-7 or BIS framework, so the recent wave of agreements rather shows the poor state of regional cooperation, in which even those rather simple mechanisms were noteworthy innovations<sup>5</sup>.

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<sup>3</sup> 11 central banks and monetary authorities from Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand are represented.

<sup>4</sup> Governors meet once a year, while there are additional meetings twice a year at Deputies’ level.

<sup>5</sup> Swap arrangements among ASEAN economies (i. e., participating countries “swapping” their own currencies compared to repo arrangements involving a third currency, namely US dollars) already have a longer tradition, but again, such arrangements are not evidence of a particularly close currency cooperation.

What possibly comes first to mind when one thinks about regional cooperation, though, is Asia-Pacific Economic Cooperation (APEC), founded in 1989. As is well known, this group brings together the governments of the Pacific region, whereas business and academic circles gather in structures like PECC or PBEC. APEC's mandate, however does not lend itself too easily to deal with financial cooperation (Adlan 1998): Its three main pillars are trade and investment liberalization, business facilitation (harmonizing product standards, etc.), and economic and technical cooperation. Although there is some financial dimension to these issues, the emphasis is clearly on facilitating the real economy, and finance in this context is rather understood as a "service industry"<sup>6</sup>. As part of the APEC Finance Ministers' process, since early 1997 efforts aimed at training schemes for banking supervisors and securities regulators or the development of suitable pension schemes have been launched. It is still somewhat misleading though, when in the Vancouver Declaration of late 1997 it is said "that as the region's most comprehensive economic forum, APEC is particularly well suited to play a pivotal role in fostering the kind of dialogue and cooperation" (APEC Leaders Meeting 1997) on financial systems. In the same declaration, it is clearly stated that the IMF is to retain the central role in responding to the crisis.

The role of ADB is small indeed. As of 1996, the regional development bank spent only some 3.8 percent of its loans on financial sector issues. The emphasis was on improving the effectiveness of the domestic banking and financial systems in the various member countries with their widely varying situations (Pascha 1999). For instance, in South Asia, which has been dominated by a public banking system until recently, the focus was on appropriate deregulation under domestic considerations. A somewhat embarrassing fact is the publication of the glossy report "Emerging Asia. Changes and Challenges" as late as mid 1997 (ADB 1997a), which repeats the usual upbeat folklore about the bright future of (Pacific) Asia.

What are the reasons that the ADB was "surprised" to such an extent by what was going to happen on its very doorstep? One answer is that the ADB is overexposed to various subregions with very different situations. Another aspect is that ADB did leave pre-crisis efforts to other institutions working on a multilateral level. After all, the crisis which started in East and South East Asia might also have started elsewhere. In early 1997, the Czech crown was under attack, and in 1998, as is well remembered, the financial markets focused on Russia and on Latin America. While the neglect of certain issues of multilateral importance may indeed be explainable and even legitimate - the main reason why one feels uneasy today is that the crisis eventually started in that very region -, this very "excuse" casts a revealing light on later attempts to play a major role, as will be shown below: for many issues it is questionable indeed whether a regional institution can play an effective role.

### *Crisis management and immediate reaction*

Let us now turn to the actual financial crisis and to responses and activities of IOs in terms of cooperation efforts. For our purposes, we can limit the relevant period to what happened between early July 1997 (depreciation of the Thai baht) and February 1998 (debt rescheduling for Korea).

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<sup>6</sup> For instance, in the statement it is explicitly said "that the impetus for much of our work on developing and strengthening capital markets was to facilitate private financing of infrastructure" (APEC 1998).

It is obvious that the lead in managing the crisis, particularly in negotiating the assistance schemes with Thailand, Indonesia, and Korea, was taken by the IMF. This is consistent with its perceived role in international economic relations.

The only challenge came from the proposal to set up an “Asian Monetary Fund” or “Facility”, which by different accounts was originally raised either by Malaysian Prime Minister Mahathir or came from within Japan’s Ministry of Finance. It entered the official stage, when it was proposed by Japanese Finance Minister H. Mitsuzuka at a G-7 finance ministers’ meeting immediately preceding the IMF/World Bank meetings of September 1997 in Hong Kong (Rowley 1997). There are suggestions that such a kind of proposal was earlier endorsed during the Shanghai EMEAP governors’ meeting of July 1997. ASEAN Finance Ministers, when discussing “financing arrangements” during a special meeting in early December 1997, reiterated that they had already “endorsed a proposal for an ASEAN financing arrangement” (ASEAN 1997b, point 8.) in their First Meeting in Phuket, March 1997. Reading the Joint Press Communique of that earlier meeting, though, there is little which resembles an “endorsement” of such a major policy issue (ASEAN 1997a).

There remains some doubt, though, who was the originator of the idea. Even in the case that it originated from Southeast Asia, it certainly was taken up as an almost Japanese initiative through proposing it in the G-7 framework. What was the motive behind it? Some observers (e.g., Rowley 1997) see Eisuke Sakakibara behind it, who is reputed to be an outspoken critic of “Washington” institutions; he was vice minister of MoF for international finance during the critical period. Apart, and possibly more important than such personal factors, bureaucrats may have thought that they could demonstrate Japanese regional leadership role - and as the fear of global contagion was not to be neglected, such activity would even had touches of assuming global responsibility. Still it is somewhat strange that of all ministries, the usually tight-pocketed MoF was so willing to promise a lot of money for cases of (external) emergency. Possibly, the ongoing turf-war between various ministries played a role. MoF is constantly fighting over influence with, among others, the Foreign Ministry and MITI. As for the important relations with Asia, these competitors, and MITI with its policy of brickworking a Pacific Asian network of cooperating industrial economies in particular, are not to be neglected. Forces within MoF may have seen a chance of consolidating its position on the Pacific Asia policy arena by promoting the concept of an “AMF”. Moreover, as the MoF bureaucracy is under constant criticism from the public due to its presumed mismanagement of the Heisei recession, it may have welcomed sponsoring the idea of an AMF in order to be appreciated as a “saviour” of Pacific Asia’s economic ascent - and of the world economy in general.

The “AMF”-proposal received an extremely cool welcome during the G-7 Finance Ministers Meeting and on the sidelines of the following IMF and World Bank meetings in Hong Kong. It was feared by North American and by European representatives that a second “alternative” for receiving assistance in emergencies could undermine the authority of the IMF, by possibly offering “discount” programmes with less strings attached.

In the pretentious format of a second Fund or Facility, the idea did have trouble to survive the Hong Kong meetings, although the programmatic term was still heard here and there in late 1998 when the New Miyazawa Initiative was announced and before the Hanoi ASEAN Meeting. Possibly, as a kind of face-saving device, the Washington institutions agreed in Hong Kong that there was some role for a regional surveillance scheme. We will report on the ensuing process below, but whatever way that may turn out, it did not have an impact on immediate crisis management.

Although regional institutions or cooperative frameworks were not directly in charge of managing the crisis, it is conceivable that regional get-togethers helped smoothen crisis management. For instance, it has been suggested that the quick decision making about offering multilateral aid to Thailand in the summer of 1997 was significantly “greased” by the earlier EMEAP meeting in Tokyo. After all, not only the IMF promised money in the Thailand (and in later) assistance packages, but also national governments and the ADB (see table 1). It seems that an informal consensus on a concerted effort among regional economies might already have been achieved in the Tokyo meeting.

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Table 1 approximately here  
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Of course, there still remains the question whether such an early consensus was indeed helpful. One of the critical points raised against IMF-led support during the Asian crisis is that solutions followed put too light a burden on the international creditors, who are frequently thought to have less than carefully invested in Pacific Asia. Bailing them out may possibly have increased moral hazard, as international investors may have got the impression from the Mexican and Asian incidents that they eventually do not bear a significant risk when investing in less than transparent environments. Seen in this light, early consensus on how to deal with Thailand may have contributed to this malfunction of the global financial system. It is conceivable that regional economies, gathering in EMEAP, were quite interested in a quick-fix of Thailand’s difficulties with little regard for external diseconomies towards the world economy, as they were quite aware that what had happened to Thailand might soon be accounted for by them.

Japan’s role as a leading voice within EMEAP is somewhat dubious as well: because of its own domestic problems, it also had a motive to be interested in a quick fix, and money to be spent on such a scheme was one of the few resources which the Japanese government thought it still had rather ample command of.

On a somewhat different level, there are hints that ADB may also have been somewhat overenthusiastic to be part of the crisis management. Reaching an agreement in the case of Korea during the first days of December was somewhat tricky, as Korean government officials tried to circumvent harsh conditions. In this environment, ADB published its intention to be part of the deal even before the agreement between IMF and Korea had been finalised (ADB 1997c), which may not have done much harm, but which at least must be considered somewhat unprofessional and did not help the case of seriously negotiating with Korean government officials.

#### *Follow-up, mitigation of effects*

Turning to the situation after agreements on how to deal with the imminent crisis had been achieved, two issues have to be separated: the first is how the agreements were followed through and the second is what further effort was made to prevent future crises and to prevent supra-regional contagion of the Asian problems.

As for the first issue, the Washington institutions and the IMF in particular were in charge of keeping in touch with the national governments to see to the faithful implementation of the agreements. The

most critical issue, of course, was to deal with political and social unrest in Indonesia and with its somewhat dubious plan to introduce a currency board for the rupiah; we cannot deal with those events and issues in more detail here. Also in other countries, the IMF had to act in a difficult environment, in which at least some of the problems were ascribed to the IMF programmes and their harsh conditions. In Korea, for instance, there was a conspicuously nationalist anti-IMF movement. Taking this atmosphere into consideration, the Washington institutions have acted remarkably smoothly, flexibly and calmly in trying to cope with the implementation process.

IOs, through endorsement by national governments, have offered additional support in the aftermath of the crisis. Much of it was contributed by or in association with the World Bank, and during the early months of 1998, a remarkable shift towards measures to safeguard social stabilisation could be noted. In Korea, for example, the combined impact of the Washington institutions turned from one forcing the country to change its economic organisation briskly to one reminding the government that doing something about social stability was important as well. It is said that a visit by World Bank president Wolfensohn in early 1998 was critical in convincing the Korean government to use scarce public funds, implying an increase of the deficit, to act in this field (Pascha/Kwon 1998).

Turning towards measures to reduce the probability of further crises, of inter-regional contagion and of further waves of the current Asian crisis, we cannot properly discuss the overall measures of IOs here, for instance in terms of how they dealt with Russia.

Instead, we concentrate on measures on the regional level and their relative importance. Arguably, the most important aspect is the process set in motion through the so-called Manila Framework, which arguably is a reaction to the doomed thrust to promote the idea of an AMF. It was drafted by 14 APEC economies in November 1997 to enhance regional cooperation and promote financial stability. More specifically:

“It includes four major initiatives: 1) a mechanism for regional surveillance to compliment [sic] global surveillance by the IMF; 2) enhanced economic and technical cooperation particularly in strengthening domestic financial systems and regulatory capacities; 3) measures to strengthen the IMF’s capacity to respond to financial crisis; and 4) a cooperative financing arrangement that would supplement IMF resources” (ADB Institute 1998b, see also Manzano/Moreno 1998, pp. 42-43).

Among these, the call for a regional surveillance mechanism is the most specific, while the fourth point is a reminder of the concept of additional emergency finance capacities. In particular, ASEAN has taken up the challenge of how to introduce regional surveillance.

Whereas quite a few observers have argued that regional organisations played but a small role in making efforts to prevent a future crisis - or a deterioration and contagion of the current one -, this critique has been repudiated by others on the notion that the major accomplishment of mechanisms like APEC and ASEAN was to defend the notion of open trade. To some extent, of course, Korea, Indonesia and Thailand have been forced to open several sectors to international competition through their IMF loans - and did not do so out of their own free will; moreover, in some cases barriers were indeed raised, for instance where tariffs had not yet exhausted the maximum rate set by the WTO agreement (Economist, 12 September 1998, p. 88).

Nevertheless, as many countries of the region have in the past followed industrial development policies involving some conscious element of targeted protectionism, it is indeed remarkable that they

have not right away turned towards protectionism as a way out of the current crisis. To some extent, insight into the danger of a possible vicious circle of devaluation and protectionism among trading partners, based on the lessons of the 1930s depression, may have convinced them not to follow such a strategy (so far). Still, discussions in regional forums may have played a role as well. It should be noted that as late as June 1998, the ASEAN trade ministers reaffirmed their will to realise an Asian Free Trade Area (AFTA) by 2003. Although that target may appear overly ambitious these days, it is a courageous call for free trade, which makes it more difficult for individual governments to seek refuge in more protectionist pseudo-solutions.

## **2. What role should regional institutions play?**

We now turn towards normative analysis and ask what role RIOs should play in regional financial cooperation. Basic criteria for drawing such conclusions are derived from the public choice point of view (Vaubel 1986). According to this line of reasoning, IOs make sense

- when there are international scale economies,
- when there are international public goods or externalities,
- when there are international cooperation failures (e.g., in prisoners' dilemma situations).

From our perspective, these factors have to be specific to or possess peculiarities on a regional level in order to allow for public action on that level. Moreover, one has to assess whether the gains to be realised through RIOs, based on one or more of the three factors mentioned above, may possibly be (over-) compensated by losses through organisation failure (principal-agent problems between individuals, national governments and organisations with their peculiar governance structure, coordination failure between RIOs and MIOs, influence of vested interest groups, domination of certain players, etc.).

Based on section 1 and what can be found in the literature, it may be sensible to focus our discussion on the following options for activities, which make up for a rather eclectic list:

- Regional surveillance of financial system reform
- (Additional) financial assistance scheme
- Technical Assistance for banking reform and supervision, management of currency policy, etc.
- Analytical capability

### *Regional surveillance*

There is a clear case for international surveillance of the current state and reform of financial systems, as there may be cases of a collusion of interests between the *national* government (regulator) and its financial industry at the cost or risk of outsiders who suffer from information asymmetry. For instance, both government and financial industry could be interested to make the banks appear more sound than they actually are and share the profits of the resulting competitive edge.

The question, however, arises whether regional institutions can play a meaningful role. After all, multilateral institutions have already acted, as shown above. Along these lines, Morris Goldstein (1998) of the Institute for International Economics has argued that the Basle Accord offers a

reasonable framework for banking reform and that countries which commit themselves to such a reform could endorse the IMF to overlook their accomplishments. From a technical point of view, a multilateral “sign of approval” certainly makes sense, because the standards to be applied are universal, so the most straightforward solution is to commission only one institution with the certification process.

The only argument for *regional* action in this context rests on the case that multilateral activity has not been and is not going to be speedy and encompassing enough in comparison to what ought to be achieved. Indeed, it has to be noted that the Basle Accord is still somewhat weak and can only be regarded as an encouraging first step. Thus, it has to be discussed whether regional engagement might deliver more.

It has been suggested that regional support may be helpful, because it could lead to “peer pressure” being exerted on governments to make them intensify reform measures. This is actually the path taken by the ASEAN process based on the Manila Framework mentioned in section 1. The argument rests on the expectation that the more “neighbouring” economies are interrelated with each other in terms of trade and investment flows, the larger is their incentive to make sure that each other’s financial systems are sound. The recent experience of regional contagion has strengthened this argument, as the regional governments are well aware of their mutual interdependence. However, this understanding of a “shared fate” may also be interpreted in terms of a collusion of interests: Regional governments - just as national governments - have a shared interest to make their economies and financial systems *appear* more sound than they actually are. Looking at the evidence of Pacific Asian economic cooperation in the past, one gets the impression that forces reinforcing and legitimizing each other’s strategies were much stronger than those pushing a neighbour into a more sensible, albeit painful policy.

In conclusion, in order to limit the role of such collusion it makes sense to attach surveillance in the sense of data collection and presentation to the multilateral level. The two major reasons are to ensure universal standards and minimise possible influences of those interested to bias information collection and presentation in a certain way. Apart from this mechanism, as a “second-tier” strategy it could be helpful to have a regional discussion process on the basis of the published multilateral evaluation. This could indeed lead to applying peer pressure, as the “true” situation - at least as far as the “truth” is known at all - is already public knowledge.

As for the institutional issue, because the case for peer pressure rests on the interests derived from economic integration, the area engaged in this process should not be too wide. From this point of view, the “ADB region” would be too wide, because it also covers Western, South and Central Asia, where concerns are totally different, and the same holds for APEC which covers the whole Pacific. Possibly, the Manila Framework group (including Taiwan) or EMEAP would be sensible delineations<sup>7</sup>. As for how to organise the discussion process, different examples come to mind (formalised EU-type of coordination with a tight organisational superstructure, informal, yet high profile meetings like G-7 or G-8, and rather detached and issue-oriented processes like OECD).

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<sup>7</sup> As for the political economy of group size and participation, developments in the real world lead to ever more complex set-ups. Recently, on a multilateral level an ad-hoc group of advanced and emerging economies (G-22) has gained prominence, as - it is said - American policy makers are concerned about the dominance of European players in G-7 or G-10 (Chote 1998).

Because applying peer pressure among sovereign nations is highly sensitive, more detached OECD-like solutions seem most appropriate<sup>8</sup>.

### *Financial assistance*

As for financial assistance, it has been doubted whether such multilateral efforts make sense at all. The main reason is that it is very difficult to insulate the curative aspects of support from the negative impact on incentives to act prudently in the first place (moral hazard). However, this paper is not concerned about this more general question, and in the following, it will be accepted that some provision of financial assistance on a transnational level does make sense.

An additional financial scheme on a regional level as a possible *substitute* for multilateral assistance, orchestrated by the IMF, is not sensible, though. Even under the condition that such an additional programme offers more adequate (“better”) solutions, there would be competitive pressure among both (or more) programmes to get accepted. Hence competition would force down conditionality and make painful, but important decisions more difficult to achieve.

It is therefore important that there is unconditional commitment to offering such assistance only additionally, in case multilateral aid delivery is not speedy enough or funds are lacking on that level. To what extent are those dangers real? As for speed, at least so far the most time consuming aspect of emergency measures was to negotiate the conditions of assistance, not the actual disbursement. Only in case of an actual lack of funds may additional regional offers therefore make sense. As for the present, although some additional provisions on the IMF level have been made (see section 1), the difficult situation in Eastern Europe and doubts about the well-being of Latin American economies have led to a shortage of disposable funds at the IMF, which could legitimize an additional regional “tranche”.

Nevertheless, even under the conditions that financial assistance can be used without serious moral hazard problems and that it is only given with multilateral endorsement, there is still the danger that the public knowledge of the availability of funds puts additional pressure on the national governments to push for this potential “aid” to be used, and on the IMF or any other multilateral “gate-keeping” institution not to obstruct the use of “regional means for regional purposes”.

On another level, introducing such a fund on the regional level gives additional weight to those regional governments in regional affairs which make these funds available. In the current environment, this means that the position of Japan as the main holder of usable assets would be strengthened. As Japan is consistently asked to make more efforts to support the region, and Japan has few other possibilities of action (lack of macro-economic demand, inefficacy of fiscal stimuli, etc.), there would be additional pressure to utilize stand-by funds. Under the current political situation in Japan, it is doubtful whether the Japanese government would and could be self-confident enough to make its strengthened influence felt in favour of prudent emergency measures. There is a real danger that the Japanese government, which will not hold a stable majority in domestic politics in the foreseeable future, would act in favour of “quick fixes” to stabilize its popularity and to silence foreign criticism, instead of opting for sustainable long-term solutions.

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<sup>8</sup> In contrast to the OECD, it may not be helpful to publish detailed country appraisals on a regular basis, though.

### *Technical assistance*

There is a general impression that those international institutions which have the means to offer technical assistance should concentrate more on doing so than on providing financial assistance. This holds in particular for international development banks like the (multilateral) World Bank or the (regional) ADB (e.g., Culpeper 1997). The principal reason is that these days the capital markets are better developed than the markets for technical expertise, which involve considerable information asymmetries, heterogenous products, difficulties to assess product quality, etc.

Whereas the basic argument in favour of the growing role of technical assistance for IOs is quite sound, it is much more questionable to what extent *regional* IOs can play a meaningful role. After all, the norms and standards of good banking and effective financial systems generally speaking are universal, particularly in such a globalised industry.

Defending a role for RIOs is usually done by referring to the peculiarities of a region<sup>9</sup>. However, the Pacific Asian region is very diverse and it is hard to see that the variety of financial system issues - and not only those - experienced in this region possesses less variety than those experienced on a global scale. Put differently, the peculiar problems of *emerging* or newly advanced economies are similar in East Asia, Latin America or Eastern Europe, so they can be approached from a multilateral perspective. Instead of a regional IO, there may rather be a case for IOs specialising on economies with peculiar characteristics (i.e., special entities for “island economies”, “emerging economies”, “transformation economies”, etc.), although this might go too far, as will be shown below.

One might argue that at least when significant problems appear within a region - clustered because of intra-regional interdependence like in the case of East/South East Asian financial contagion -, a regional institution could redirect its resources better than a truly multilateral organisation with its multitude of tasks. However, successful redirection is difficult to achieve because know how and human capital resources of an organisation cannot easily be shifted from, say, agricultural development to banking supervision. Moreover, even when this is possible, a redirection of resources implies that other important issues are being neglected. Currently, there is unrest among the poorer member economies of the ADB, for instance, because they feel too much money and effort of the bank is spent on the richer members with their acute financial problems (Tripathi 1998).

Based on a similar reasoning, it is difficult to build new organisations around specific issues or to attach respective units to institutions otherwise unrelated to giving such technical assistance (APEC, ASEAN, etc.). After they have eventually built up enough know how, the basis for multilateral or regional policy making may have already shifted. There have been studies arguing that because of this phenomenon, there are many existing IOs in search of a new meaning, as the old legitimisation has gone (Vaubel 1986).

Another argument in favour of RIOs giving technical assistance does not rest on supposed intra-regional peculiarities, but on the role of competition among IOs for better results. The importance has risen since the Washington institutions are under mounting criticism that their strategies to overcome the crisis are too austere. In such a case, a regional alternative with “better” programmes would be

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<sup>9</sup> Recently (September 1998), an ADB banker defended the role of ADB in the Far Eastern Economic Review by arguing: “And the ADB’s competitive edge lies in its being closer to the ground and understanding the region” (Tripathi 1998).

welcome news. However, the knowledge market, as mentioned, is quite intransparent and it is not clear whether the instrumental variable through which various IOs compete would really be “quality”. A national government might settle for technical assistance from institution B and not - as we assume to know - from “superior” A, because less disturbing questions may be asked, because there are interpersonal links, or for similar reasons. As different performance in the world of economics is difficult to ascribe to a less sensible advice, so it would be difficult to punish the government even ex-post for having selected the inferior IO. Because of these imperfections of the knowledge market, simply introducing competition may not lead to superior outcomes; on the contrary, it is not too difficult to imagine frameworks in which competition would merely lead to inferior selections being made.

### *Analytical capacity*

In order to avoid this incentive problem, a possible solution could be to make sure that the competing institutions A and B are checked by some other competitive mechanism which evaluates “quality”. To our mind (also: Pascha 1999), peer pressure from the international community of social scientists in a wide sense and from economists in particular would be such a mechanism. To make this idea work, though, it would be necessary

- for the participating institutions to have clearly spelled-out strategic concepts competing against each other,
- and thus to possess enough intellectual capacity to engage in such activity,
- plus an open international discussion with a high-quality evaluation of institutional performance.

For these prerequisites to be fulfilled, relatively ill-equipped RIOs would hardly do. For instance, the ADB so far lacks the personnel to engage in such high-calibre activities. As for high-profile reports like “Emerging Asia” (ADB 1997a), in the future it will not do to “hire” well-known outsiders like Jeffrey Sachs for such important, strategic tasks.

In this context, it may indeed be interesting to make the voice of the region more audible in international affairs. It has often been argued that the model of “East Asian developmentalism” might offer an alternative to Western concepts of industrialisation and to the approach of the Washington institutions in particular (e.g., Ohno/Ohno (eds.) 1998). It may suffice here to mention the controversy on the 1993 East Asian Miracle report of the World Bank in this context. However, no institution of the region has yet proposed a convincing and consistent alternative view with strong analytical and predictive power. While it is true that the Washington institutions have been somewhat helpless with respect to forecasting and dealing with the crisis, the regional institutions, which think of themselves as knowing best what is going on in Pacific Asia, have not fared better. For instance, the famous “flying-geese-approach”, which has often been referred to when making political efforts towards more economic cooperation in Pacific Asia, shows remarkably little regard for financial systems and political-economic conditions<sup>10</sup>.

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<sup>10</sup> This is not to argue that representatives do not possess interesting insights. I remember a conversation with Professor Ippei Yamazawa of Hitotsubashi University, who is a leading proponent of the flying-geese-approach in the wider sense, which he prefers to refer to as catching-up product cycle approach. I asked him what he thought to be the next major issue, for instance to be tackled by one of his students. He answered that he considered the financial markets most important - and this remark was made in 1983 or 1984, not only before Japan’s Heisei recession, but even well before the bubble economy.

Japan could play an important role in making the means available for setting up a research framework to look for alternative explanations and recipes, which could compete the intellectual resources concentrated in Washington, D.C. This would also be well in line with Japan's intention to make a noticable mark in international relations. It would be important, though, to accept global standards of scientific discussion and critique for such an effort. A cosy regional environment would not do to develop a challenge to conventional theoretical and policy knowledge.

As for institutional affiliation, the newly founded ADB Institute could well serve such a purpose. It will have to be drawn into a global framework of scholars and policy makers, though, and must not develop a character of a more or less functional service unit for the immediate tasks of the Manila-based ADB. Moreover, it will need a critical minimum of resident scholars and frequent visitors to be of consequence.

### **Final remarks**

This paper has dealt with financial cooperation and integration in Pacific Asia both from a positive and from a normative point of view: what is being done and what ought to be done? Whereas most contributions stress the role of multilateral - in the sense of globally operating - institutions, this paper has focussed on the role of *regional* institutions. Boiling down what has been argued above, our view on what has been done on the regional level and what could and should be done is quite pessimistic. The most basic reason is that in the financial markets multilateral interdependence is so strong that it is quite difficult to make the case for a regional approach.

Should regional cooperation in financial matters still play a growing role? If one wants to propose such an argument, we argue that it can hardly rest on economic grounds. Rather, there may be political reasons to suggest that the advanced and emerging economies of Pacific Asia need more channels of cooperation to smoothen their relations based on mutual interdependence. This would be an ad-hoc approach, not resting on foreseeable economic cases for cooperation on specific issues, but on eventually emerging topics. Such an "open agenda" would be very similar to what has been proposed for APEC during its inaugural years.

However, there are not only potential benefits of such an "open agenda", but also dangers. The major problem is that cooperation within a regional "club" may not only lead to activities which benefit all - including outsiders -, but may also lead to collusive behaviour, impairing others. In the paper, we have identified various scenarios in which that may happen. Therefore, it is legitimate for the international community to discuss the pros and cons of such developments: regional cooperation in finance is not only a regional matter.

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