

International Monetary Co-operation in Asia

Talk by the Governor, Mr I.J. Macfarlane, to Europe/East Asia Economic Summit, Hong Kong, 20 November 1996.

I am pleased to be invited to speak to the Europe/East Asia economic summit on the topic of International Monetary Co-operation in Asia. It is a topic to which we at the Reserve Bank of Australia and our colleagues in other central banks in the region have given a great deal of thought.

As many of you may know, my predecessor, Bernie Fraser, was a keen advocate of co-operation between central banks in the region. So am I. A little over a year ago, he spoke on that topic, suggesting that the already good relationships between central banks in Asia provided a solid foundation for more substantial forms of co-operation in several areas. He suggested that the kinds of co-operation currently carried out by the eleven EMEAP¹ countries could lead almost naturally to the idea of a purpose-built, Asian institution for central banks, akin to the Bank for International Settlements (BIS), a view which I want to re-state today.

That suggestion attracted a good deal of attention at the time, as a number of others had also been thinking about ways of furthering co-operation between central banks. In the ensuing period, interest in

monetary co-operation in Asia has increased, including from some institutions outside the region. More importantly, within the central banking community, there have been further steps towards genuine co-operation over the past year.

It is therefore timely to re-visit the general subject, to assess the progress made over the past year, and to offer one or two observations on possible future directions.

In doing this, I will adopt a fairly general definition of 'monetary co-operation'. In particular, the areas where central banks are seeking to establish and further co-operation go well beyond monetary *policy*, important as that topic is. Monetary *policy* is primarily a domestic responsibility of central banks, aimed at domestic objectives, but international co-operation in several areas is an important adjunct to good monetary policy. This alone justifies a broad interpretation of the topic, but central banks also have another broad responsibility – namely financial stability, including in most cases supervision of banks and involvement in payments system issues. They are also participants in international markets, as part of the management of the international assets on their own balance sheets. All of these require an international perspective, and so co-operative relationships on several fronts are mutually beneficial.

1. EMEAP stands for Executive Meeting of East Asia and Pacific Central Banks. The relevant central banks are those of Australia, People's Republic of China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand.

Because the topic is reasonably broad, the set of institutions which will have an interest in it also extends beyond central banks. So later I will also address the question of the appropriate relationship between the central banking forum and other groupings of various kinds.

The Nature of Asian Monetary Co-operation

It is worth stating at the outset what such co-operation is *not* about. I don't think anyone is contemplating monetary *integration* and there is no talk of a co-ordinated monetary policy, or an 'Asian exchange rate mechanism', despite what some press reports have suggested. Similarly, any thought of a 'yen' bloc seems rather fanciful. There is far too much diversity in levels of economic development, economic structure and rates of growth for such an approach.

Neither is central bank co-operation designed to provide a *safety net* for countries in need of structural adjustment for balance of payments purposes. To the best of our knowledge, none of the central bank participants in the present discussion has this idea in mind. No one envisages an aid or development institution or some sort of regional version of the IMF making loans for the purpose of facilitating structural adjustment. Such institutions already exist, both globally and regionally. Whatever their respective strengths and weaknesses, adding another institution to do similar work would not be a step forward. Even if such institutions did not already exist, it is not the function of central banks to make loans to other countries for which there is a risk that they would not be repaid. A decision to put a country's resources at risk in this way would need to be made by the elected Government. The institution we have in mind is more limited; it would confine itself to offering various services and assistance to central banks to pursue their own legitimate purposes. That may mean, on some occasions, providing international

liquidity to central banks on a short-term collateralised basis, but its lending activities would not extend beyond that.

Having established what Asian monetary co-operation does not mean, I should restate what I think *is* involved.

The need for co-operation is driven by the fact that there are international policy externalities in a globalised, and increasingly liberalised, environment. Experience suggests that markets operating in a fairly free manner generally produce substantial benefits for the citizens over the long run. But it also demonstrates that a degree of oversight, and a capacity for policy makers to intervene in markets under certain conditions, are likely to be ingredients of a well-functioning system. In today's capital market, where flows are large and rapid, and in tomorrow's world where these tendencies may have increased further, there is an added dimension. Another country's policies, and its problems, can have repercussions in our own countries in more forceful ways than in the past.

With the economic and financial growth in Asian countries likely to continue to outpace that of the world generally, more attention needs to be given to regional arrangements for co-operation. Central banks and other policy authorities are obviously vitally interested in these issues, though of course there is a major role for the private sector as well.

The appropriate response to this situation is to develop co-operative arrangements between central banks at several levels.

- At the most elementary, understanding each other's policies and priorities, and being able to learn from others' experiences. Of course there is much study of various aspects of this by academics, but it is important for central banking practitioners to invest in learning as well. An important part of this process simply involves building up a genuine rapport with our counterparts in other central banks, so that we can pick up the phone and communicate quickly and effectively when needed.

- At a more formal level, there is the collection of information on market practices, regulation, supervisory standards and the like on a consistent basis. This also involves sharing timely information on current and prospective developments in economies, financial markets and capital flows, including forming views on policy initiatives coming from the major countries. In times of market instability, basing policy judgments on sound information is crucial. To be able to do that, we need in the more tranquil times to build the information framework and communication channels between authorities across borders.
- Generally furthering the development of a sound financial infrastructure, in which we have a collective interest. This includes such things as improving the resilience of payments systems, and exploring the scope for harmonisation or at least co-ordination of policies on market regulation and bank supervision. In ten of the eleven EMEAP countries, the central bank is the bank supervisor, and there is clearly a lot of room to co-ordinate policies and make sure that regional views are heard in international fora such as the Basle Committee. It also involves developing specific mechanisms for co-operation in areas such as foreign exchange markets, in the interests of promoting monetary and financial stability. There is an increasing role, for example, for central banks assisting each other in certain official transactions – be they in the nature of foreign exchange intervention, or structural shifts in reserve holdings.
- In an institutional setting, the possibility of providing services to central banks to assist in the management of official reserve assets, which in this region are large and, at present, growing quickly.

Progress to Date

We should first acknowledge that there has always been a co-operative spirit between many of the region's central banks particularly with respect to training and secondments. Having said that, however, there has been an appreciable lift over the past few years in the progress that has been made in building on existing relationships.

One manifestation of this was the signing, at the instigation of the Hong Kong Monetary Authority, of a series of bilateral repurchase agreements in US dollar funds by a number of central banks. This took place last November. A number of further similar agreements have since been signed. The Reserve Bank of Australia, just as one example, now has agreements of this kind with Hong Kong, Thailand, Indonesia, Malaysia and Japan.

Another step toward co-operation was that the Bank of Japan, in conjunction with the Ministry of Finance of Japan, recently established agency arrangements with the Monetary Authorities of Singapore and Hong Kong to give Japan an enhanced capacity for foreign currency intervention in those markets. This initiative augmented a similar relationship which has existed with the Reserve Bank of Australia for some years.

So there are several instances of heightened co-operation developing on a bilateral basis. Some good progress has also been made within the EMEAP forum. This group has been meeting at Deputy Governor level since 1990, but in 1996 it stepped up its activities. The first meeting of EMEAP members at Governor level took place in Tokyo in July, to consider a report of a group of officials convened to study scope for co-operation between central banks. An outcome of that meeting was the establishment of two working groups and a study group to look at issues of financial market development, central banking operations (including various possibilities for institutional development) and banking

supervision, in an ongoing capacity. These groups began their work recently, and will report regularly to the meetings at Deputy Governor level, which will continue. The next meeting of Governors will take place next year in Shanghai.

The EMEAP group is not, of course, the only forum in which central banks in the region deal with each other. There are several others, some of which have been in operation a long time. SEANZA (South East Asia, New Zealand and Australia), which was established in the 1950s and has quite a broad membership, has primarily a training function. SEACEN (South East Asian Central Banks), which also has a distinguished history, fulfils a similar role for its members, with the added advantages of having a permanent headquarters and secretariat in Kuala Lumpur and regular meetings of Governors.

All of these have their role to play. The EMEAP forum, however, is the only one which was established specifically to foster high-level engagement between central banks on *policy issues* at the regional level. It has a fairly wide representation, but is still a manageable group. We in Australia see it as the most promising base for further regional co-operation between central banks, although we understand that individual countries will give high priority to other institutions and bilateral arrangements.

Issues for the Future

Although useful progress has been made, a good deal more work needs to be done in transforming the notion of co-operation into further concrete initiatives. I expect that the EMEAP working groups will make some recommendations over the next year or two. I do not want to pre-empt their findings. I should make it clear, however, that the Reserve Bank of Australia's view remains that there is scope for the development, in time, of a regional institution owned by central banks – an Asian BIS. Such an institution would exist

to assist central banks in the conduct of their responsibilities through providing services, a forum for discussion, research and analysis, a point of co-ordination for co-operative efforts in market transactions when needed, an avenue for the management of reserve assets, and a regional voice in dealing with the other major regions on central banking matters including bank supervision.

This is not the appropriate forum or time in which to spell out the fine details of such an undertaking. There are a couple of important questions, however, on which I would like to touch.

The first is the relationship between an Asian BIS, in whatever form it might one day take, and other important international groupings or institutions. This relationship should be a constructive one. Certainly, the existing international institutions should not see the recent central bank initiatives in Asia as a threat. On the contrary, they should welcome and encourage them. Better international monetary arrangements in Asia will benefit the countries concerned, but that is not all. As the region's economies continue to grow in size, and as financial systems develop and mobilise the considerable flows of savings in the region, good monetary and financial infrastructure will make a tangible contribution to global stability in years to come. The question is how to construct and maintain that infrastructure. The present course seems to offer a good chance of producing the sorts of benefits we are looking for.

It would be a mistake, I think, to see the EMEAP forum and a possible Asian BIS at some future time, as competing with existing international institutions, particularly the Basle BIS. The two entities should be *complements*, not competitors. The BIS is a valuable institution, which provides very useful financial services for central banks and a forum for the resolution of problems common to central banks. It has a lot to offer central banks from this part of the world. The BIS's structure, however, including the structure of its share registry, virtually guarantees that it will always be dominated

by the original shareholder countries, with a heavy European focus. That means, I think, that a regional institution in Asia, which could claim to represent the central banks of countries in this part of the world, would have something to offer the BIS, and in turn, the BIS could probably offer a great deal of assistance. So I think there is scope for a constructive relationship between central banks in Asia and the BIS on the question of prospective Asian central banking arrangements.

There is also the question of the relationship between the central banking forum for Asian co-operation and other groupings of economic agencies and departments of government. Economic co-operation generally encompasses a much wider range of issues than those which are the core responsibilities of central banks alone. In the financial and monetary field, Treasuries and Ministries of Finance naturally have important interests and responsibilities and some areas of economic co-operation involve foreign policy as well. As a result there are a number of international groupings with wider membership than just central banks.

These various groupings will tend to overlap, and each will perhaps want to pay close attention to what the others are doing. But each has its place. This is a parallel to the domestic scene in most countries, where central banks, Treasuries/Finance Ministries and Ministers all have their own role to play, and where it is important for good policy making to develop and maintain professional and productive working relationships. There

is also an important international parallel, where the BIS is the institution at which Governors of central banks of major countries meet, and the G7 (and IMF) where Finance and Treasury Ministers plus central bank Governors meet. Again, the objective should be constructive complementarity, not bureaucratic territorialism.

Conclusion

Asian monetary and financial co-operation is gradually developing. It is a common-sense response to the changing circumstances in which countries in this time zone find themselves. Some useful progress has been made. But the process can deliver considerably more, if pursued persistently and sensibly.

Initiatives in this area are not intended to threaten in any way existing international arrangements or institutions. Indeed the fact that the central banks concerned have got together with the aim of developing mechanisms which will help in fostering financial and economic stability in the region should be welcomed by other bodies. The central banks will be seeking opportunities to work co-operatively, with the BIS, and with other regional groups. We at the Reserve Bank of Australia look forward to continuing to work with our colleagues in central banks and other institutions in pursuit of the goals of macroeconomic stability and prosperity.