

Central Bank Cooperation in the Asian Region

Talk by Governor, Mr B. W. Fraser, to the 24th Conference of Economists, Adelaide, 25 September 1995.

I am pleased that cooperation among countries in Asia is such a prominent theme of this 24th Conference of Economists. More than ever before, we are living in an era of global markets, but that does not mean regional groupings are losing their relevance. Indeed, given that we have an international monetary system that is more akin to a patchwork quilt than a seamless robe, well crafted regional cooperative arrangements will actually help countries to reap the full benefits of more open world trade and financial markets.

A lot has been said in recent years about the 'Asian region' and of Australia's involvement in it. This talk has been mainly trade related, that being the area of perhaps the greatest – and certainly the most obvious – opportunity. But in other areas, too, improved cooperation among countries of the region could yield substantial benefits. These include areas of central bank cooperation, which is the main focus of my talk today.

How the 'Asian region' is defined is largely a matter of choice. In my view, it is appropriate

that we have a number of different groups: it is inconceivable that any one group would be optimal for all purposes. In practice, different groups co-exist, overlap and change over time. What is important is that each group be capable of generating tangible and mutual benefits for its members.

APEC

Our interest is understandably greatest in groups which include Australia. In the field of trade and investment, APEC (Asia Pacific Economic Cooperation) is the pre-eminent group from Australia's perspective. The group was formally initiated in November 1989, with the aim of promoting cooperation on trade and investment issues. APEC now comprises 18 members, including some non-Asian countries.¹

It is a substantial bloc. APEC countries account for 39 per cent of the world's population, 51 per cent of world GDP and 43 per cent of world trade. Its members have always traded extensively with one another, and intra-APEC trade currently represents

1. The original 12 members were Japan, the Republic of Korea, the Philippines, Indonesia, Malaysia, Brunei, Singapore, Thailand, Australia, New Zealand, the United States and Canada; then followed the People's Republic of China, Taiwan, Hong Kong (all in 1991), Mexico (1993) and Papua New Guinea (1993). Chile, the newest member, joined in November 1994.

around 75 per cent of the group's total trade. This share is likely to increase further as existing trade barriers are gradually dismantled.

The Bogor Declaration of November 1994 commits developed members of APEC to open trade and investment flows with other members by 2010; developing country members are committed to achieve the same objectives by 2020. These deadlines seem too close for some, and too distant for others. Seen in an historical context, however, their realisation would be a substantial achievement; in Europe, 35 years elapsed between the Treaty of Rome and the creation of the Single European Market in 1992.

Many hard decisions lie ahead, but the APEC initiatives are clearly supportive of the cause of freer world trade. If countries which account for nearly half of the world's trade succeed in removing barriers among themselves, that should strengthen the multilateral trading system. It should also enhance APEC's leverage on other regional and international groups professing similar objectives.

Another part of APEC's charter is to remove barriers to the flow of capital among members over the timeframes mentioned. These flows help to sustain robust rates of economic growth, but they can also raise problems for policy makers. They can, at times, destabilise financial markets, and this risk would be heightened by moves to lift exchange controls on capital flows, unless other policies are also changed. For this reason, APEC Finance Ministers have been turning their minds to ways to counter any unintended consequences which could frustrate freer trade and investment in the region. In their Jakarta Communiqué, they noted that uncertainty and ignorance in financial markets were often causes of destabilising capital movements, and resolved to try to ensure a better flow of information to financial markets. They acknowledged, too, the need for capital

markets in the region to be further developed and deepened.

Some of these issues – including the monetary policy implications of large capital inflows – are obviously relevant to central banks. In varying degrees, the central banks of APEC countries do become involved when these matters are considered. For the most part, however, APEC seems likely to remain the domain primarily of Trade, Finance and Foreign Ministries, and to concentrate on areas in which those ministries (rather than central banks) have the greatest comparative advantage.

As I said, my focus today is on central bank cooperation. I should also make clear at the outset that the emphasis is very much on *cooperation* – not economic and political *integration* on the European model, with its associated goals of a common central bank and currency.

Regional Central Bank Groupings

Several associations of central banks already exist in the Asian region. One of the oldest and largest is SEANZA (South East Asia, New Zealand and Australia), which was established in 1957 to conduct intensive, biennial central bank training courses. Membership has grown from the original five central banks to the current 17.²

SEANZA training courses bring together officers from what are quite diverse central banking systems. This diversity is their distinguishing feature, although it also complicates the task of structuring courses which are relevant to the needs of all the participants. Annual meetings of SEANZA Governors are also held; these bring together, albeit briefly, central bankers from what is arguably the broadest possible definition of 'Asia'. The very diversity of this group,

2. To the original five (Australia, India, New Zealand, Pakistan and Sri Lanka) have been added Bangladesh, the People's Republic of China, Indonesia, Iran, Japan, the Republic of Korea, Malaysia, Nepal, Papua New Guinea, the Philippines, Singapore and Thailand. Hong Kong has formally applied for membership and its application is expected to be considered by SEANZA Governors at their next meeting in Beijing in October 1995.

however, argues against its practicality as a platform for more intensive central bank cooperation outside the training area.

Another group which also holds annual meetings of Governors and operates a training centre is SEACEN (South East Asian Central Banks). SEACEN originated in 1966 and currently has ten members – Indonesia, the Republic of Korea, Malaysia, Myanmar, Nepal, the Philippines, Singapore, Sri Lanka, Taiwan and Thailand.³ Australia is not a member of SEACEN, but the Reserve Bank regularly makes available senior officers to lecture at SEACEN training courses.

The newest regional central bank group is EMEAP, a less-than-memorable acronym which stands for Executive Meeting of East Asia and Pacific Central Banks. This group grew out of an initiative by the Bank of Japan. The first meeting was held in February 1991, and was attended by central bank representatives from Australia, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. Membership was later expanded to eleven, with the addition of the central banks of the People's Republic of China and Hong Kong. EMEAP meetings are held twice a year, hosted alternatively by the Bank of Japan and another member central bank; representation is usually at Deputy or Assistant Governor level.

By any measure, its member countries make EMEAP a substantial group. Just how substantial can be seen from the following comparisons with the 15 member-country European Union (Table 1).

The half-yearly meetings of EMEAP are valued highly by the Reserve Bank and, we believe, by other participating central banks. The meetings are relevant and informative; the fact that Japan is a member of G3 and G7 provides potentially useful linkages for information sharing with those other groups. EMEAP does not, however, have any policy development or operational functions.

The questions I want to explore today are whether cooperation among regional central banks should be extended into these (and other) areas, and how that might be best achieved. My answers, in brief, are that greater cooperation is desirable, and that a new regional institution is the best way to achieve that.

A Rationale

Perhaps the single most important argument for a new regional institution is the advent of global markets – including for currencies and financial instruments, which are of special interest to central banks. This seemingly relentless process offers the prospect of stronger growth in world trade and development, through better use of the world's capital and other resources. But it also promises a bumpy ride for many countries. Those countries which have not yet done so can expect to come under mounting pressure to liberalise their financial markets. Concerted discussion, and the sharing of experiences of

Table 1: EMEAP and EU

	EMEAP	European Union
Population (million)	1,728	369
GNP* - US\$ billion (1993)	7,615	6,171
- Average growth 1992-94 (%)	6.7	1.1
National saving ratio - Average (%)	35.0	18.2
Foreign exchange reserves - US\$ billion	388	343

* Calculated on the basis of purchasing power parity exchange rates.

3. Five of these countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), together with Brunei, comprise ASEAN (Association of South East Asian Nations), which also organises meetings of central bankers.

both the macroeconomic and regulatory implications of financial liberalisation will require a more deliberative forum than that provided by current EMEAP arrangements.

Globalisation of markets also increases the chance that problems in one part of the world economy will break out elsewhere. We had a foretaste of this with the currency crisis in Mexico earlier this year, which posed certain threats to some countries in this region. In other words, globalisation is elevating the international dimension of monetary cooperation. Domestic policies will always have to be the main line of defence in response to these threats, but even sound domestic policies may not be sufficient in the face of massive short-term swings in cross-border capital flows. Cooperative and coordinated responses on the part of several central banks might be called for, as well as – on occasions – access to emergency financial support.

How is this international dimension best handled? Existing institutions are relevant but not ideal. The Asian Development Bank (ADB) is an important financial institution in the region but its forte is longer-term development assistance. The IMF is an important international financial institution; it can, for example, exert pressure on domestic policies by attaching conditions to the assistance it provides. Most EMEAP countries, however, are unlikely to be frequent recipients of conditional loans. In any event, assistance that might be available from an institution as large as the IMF (it has the interests of 179 members to reconcile) might not be available as quickly as it is required. The IMF is currently exploring options to improve its responsiveness to situations requiring emergency financing, but there is still a case, in my view, for close neighbours to have their own mutual support arrangements to deal quickly with emergency situations.

The Bank for International Settlements (BIS) is a promising model in this context.

Its members ('shareholders') are exclusively central banks, and it has become the principal forum for discussion, consultation and cooperation among central bankers in western countries. Its main drawback from an Asian perspective is that – notwithstanding its name – its membership is 'international' only in a quite narrow sense. All but five of its 33 shareholders are central banks of European countries and 13 of its 17 Board members are Europeans.⁴ Despite the progress towards broader participation that has been achieved in some areas by the current General Manager, the BIS remains quintessentially a G10 institution, with an overwhelming European orientation.

In short, no existing institution could expect to match the particular focus or immediacy of a regionally-based institution dedicated to central bank cooperation. An alternative to a new institution is, of course, enhancement of the non-institutional EMEAP arrangements. That, too, would be a matter for the central banks concerned. My own view is that, as valuable as current EMEAP arrangements are, deeper and on-going central bank cooperation will require a proper institutional framework. For that to materialise, a sufficient number of central banks would need to be satisfied that the potential benefits outweighed the costs.

Functions of a Regional Central Bank Institution

I want now to indicate in a little more detail the kinds of functions an institution modelled on the BIS and serving EMEAP-based central banks could perform. In essence, the aim would be to perform broadly similar functions to the BIS in the Asian region. It would complement, rather than compete with, the BIS. Operating with similar objectives, the new institution would hopefully contribute to

4. The current country representation on the Board of Directors is Germany (2), Italy (2), United Kingdom (2), France (2), Belgium (2), the Netherlands (1), Sweden (1), Switzerland (1), United States (2), Canada (1), and (the only Asian country) Japan (1).

more effective cooperation among central banks on the global stage (in much the same way that APEC will hopefully contribute to the objectives of freer world trade and investment flows).

The main functions which I will mention are, to a degree, mutually reinforcing.

Information and Experience Sharing

I noted earlier that EMEAP countries add up to a substantial bloc. Their economies, on average, have grown about three times faster than the average for OECD economies over the past decade. Given their generally high saving ratios and growing intra-regional trade and investment ties, their relatively rapid growth rates are likely to continue. These, in the normal course, will throw up their own challenges for economic policy makers (including central bankers).

Increased cross-border capital flows consequent upon the progressive deregulation of domestic financial markets can be expected to bring an additional set of challenges. In this environment, the task of maintaining growth and controlling inflation will become more difficult, with additional constraints on the operation of monetary policy, especially where exchange rates are fixed or sticky (as they are in several Asian countries). Central banks will not be the only policy makers affected by these issues, but they will have a pivotal role to play in most countries. A regional institution would provide for more structured and sustained discussion, experience sharing, monitoring, research and cooperation in these policy areas than is possible under the current, informal arrangements. A permanent secretariat – not large but competent – would be required to help give focus and continuity to this cooperation.

Emergency Support Mechanisms

Crises can and do occur but they are virtually impossible to predict. Being prepared requires on-going discussion and effective contingency plans. It can also entail emergency assistance in exceptional circumstances. This contingency planning and response capability constitute a second broad

function of a new regional institution, and a logical extension of the first.

Notwithstanding their high saving ratios, many EMEAP economies also have a significant reliance on foreign capital. Increasingly, this is taking the form of private short-term capital flows, which are potentially volatile and likely to become more so as the globalisation of currency and financial markets spreads. These flows can react quickly to changes in market expectations and news, often independently of changes in economic fundamentals, and often in response to developments outside the region – something like guilt by association, however mistaken that might be.

Central banks can respond to serious destabilisation of this kind in different ways to meet a variety of needs. Responses could range, for example, from information sharing, through coordinated foreign exchange operations and foreign exchange swap agreements, to more highly structured temporary credit facilities. A regional institutional framework could usefully facilitate all these kinds of activities, and would probably be essential in the case of more highly structured facilities. It would have the focus and primacy to pursue effective action, which usually means quick action.

Generally speaking, central banks have more freedom to act in their particular spheres of responsibility, and can usually move more speedily than other organs of government when they need to. They are more able to, as they say in the Nike ads, ‘just do it’ (after, that is, they have established their guidelines, including in this context, the basis on which any new regional facility would co-exist with other international facilities).

Certainly, there can be no doubting the capacity of regional countries to mount a new facility, as well as to participate fully in broader support schemes. The total foreign exchange reserves of the seven EMEAP countries with the largest reserves, for example, more than match the total of G7, widely regarded as the world’s most influential economic group (see Table 2). (This, incidentally, is only one reflection of the remarkable – but still not

Table 2: Foreign Exchange Reserves, December 1994
(Excluding gold)

G7 Countries	US\$ billion	7 EMEAP Countries*	US\$ billion
United States	41	Japan	115
Japan	115	Singapore	58
Germany	72	Hong Kong	53
France	24	People's Republic of China	52
Italy	30	Thailand	29
United Kingdom	39	Republic of Korea	25
Canada	10	Malaysia	25
	331		357

* Taiwan is not a member of EMEAP but its foreign exchange reserves at the end of 1994 totalled more than US\$90 billion.

widely appreciated – changes which have occurred in many countries in the Asian region over the past decade.)

Supervision and Surveillance

Many EMEAP countries are likely to be under increasing pressures to liberalise their financial markets, not only from outside but also domestically as capital requirements for business and infrastructure outgrow traditional sources and institutions. It is possible that the existence of some regional emergency support mechanisms would be helpful in this regard, to the extent that it provided some additional confidence to the authorities contemplating liberalisation measures.

More generally, central banks will be involved in the supervision of their banking and financial systems through what are likely to be rapidly changing circumstances. No supervisory model is applicable to all countries, irrespective of their stage of development. What is appropriate for Australia or Singapore, for example, is not necessarily appropriate for Indonesia or China. This suggests an argument for a regional institution to facilitate discussion and the sharing of experiences and insights among central banks on bank supervision issues, similar to that raised in the context of the monetary policy implications of volatile cross-border capital flows.

Again, existing international arrangements are not ideal from an Asian perspective. Most

of the running on the big changes in bank supervision has been made by the Committee on Banking Supervision established 20 years ago by the G10 countries under the aegis of the BIS. It was this Committee which devised the capital adequacy requirements in relation to credit risk (that is, the risk of counterparty failure) and which is currently putting the finishing touches on proposals to require capital to be maintained against market risk (that is, risks from movements in interest rates, exchange rates and equity prices). Once standards or requirements of these kinds are agreed in the Committee, and adopted by the central banks in G10 countries, there is considerable pressure on others to follow suit – otherwise their banks risk being perceived as somewhat inferior institutions in competitive situations.

The Reserve Bank is a shareholder of the BIS but, not being a member of the G10, it is not a member of the Committee on Banking Supervision where these issues are discussed and largely decided. We do have an opportunity to comment on proposals before the Committee (such as the current market risk proposals), but that is very much a second best situation. It is, however, ahead of the position for most other countries in the region. Even those with sophisticated banking systems are effectively and unfairly discriminated against because certain concessions in the current BIS risk weights for capital adequacy purposes are restricted to banks from countries which are members of the OECD (at present only Japan,

Australia and New Zealand among EMEAP countries are members of OECD).

A regional institution might help to make the views of countries in the Asian region better known in bodies like the BIS and its Committee on Banking Supervision. More importantly, it could facilitate cooperation on the growing international element in financial surveillance as banks and other financial institutions spread across national boundaries. Regional banking systems are likely to become increasingly interdependent as trade and investment links develop further. This will generate a growing community of interest in safe and efficient banking systems in individual EMEAP countries.

Similar comments could be made about clearing and payments systems. These systems are critical to the proper functioning of all our economies but we hear little of them (until something goes wrong). Currently, about half the central banks of EMEAP countries (including Australia) either have or are in the process of establishing payments systems for high value interbank payments which are based on Real Time Gross Settlement (RTGS). Because they are in real (as distinct from deferred) time, such systems eliminate interbank settlement risk, and minimise the possibility of systemic difficulties arising from problems in one area of the financial system. They also eliminate settlement risk in foreign exchange markets.

As economies grow and markets of all kinds are progressively deregulated, the volume of transactions flowing daily across the borders of regional countries will go on increasing dramatically. A valuable and legitimate function for a regional institution of the kind envisaged here would be to help strengthen the linkages among payments systems within the region, and between the Asian region and other regions.

Banking Services

Finally, and in part as an adjunct to its other functions, a new regional institution of the BIS model would be able to offer member (and

non-member) central banks a range of financial and investment services. In this role, it would be a bank for central banks, in the way that the BIS has become. (In this role also it would be, to some extent, a competitor with the BIS.)

The BIS assists central banks to manage and invest their foreign exchange reserves, and is active in foreign exchange and financial markets as an agent of central banks. It provides deposit and other investment facilities which are tailored to the particular needs of central banks in managing their reserves, and which are of a kind (and with a credit rating) commercial banks could not provide. Some 100 central banks hold short-term deposits with the BIS; these are estimated to be equivalent to about 10 per cent of global foreign exchange reserves, and include substantial sums from central banks in the Asian region. The spread which the BIS makes on these deposits and transactions not only covers its operational expenses, but also generates profits and dividends for its shareholder central banks.⁵

There is no reason why Asian central banks could not organise a regional institution to provide competitive services of these kinds, essentially as an adjunct to its other functions. Certainly, the talent, financial resources and opportunities exist in the region to make this practical.

Conclusion

In summary, a good case can be made, in my view, for establishing a new institution to promote cooperation among central banks of the region (*not* a regional central bank). A minimum approach might be a modest permanent secretariat servicing regular meetings of member central banks, but a much better prospect, in my view, is the BIS model. That is, an institution with its own capital (to be subscribed by member central banks) and its own balance sheet. As such, it

5. Net profit in 1994/95 was of the order of US\$315 million, of which a little over US\$100 million was paid in dividends to shareholder central banks.

would have the flexibility to perform the range of functions and financial services I have alluded to.

Its establishment could proceed in general harmony with on-going moves to strengthen trade and investment ties in the region (in their various configurations), but on its own track and timeframe. Building upon the strengths

of its member central banks, but operating within a broader, enlightened international framework, it could contribute to both regional and world prosperity.

That is the thought I would like to see explored further by my colleague central bankers in EMEAP. It is the thought I would like to leave with you this morning.