

Report Summary of Studies on  
“Economic Surveillance and Policy Dialogue in East Asia”<sup>i</sup>

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The study group working on “Economic Surveillance and Policy Dialogue in East Asia” first supplies definitions for “surveillance”: what is surveillance, why it is needed, how and where it should be done by whom. The study assesses the existing frameworks and organizations, providing the description and reveals why they are not sufficient for East Asia. Finally the study attempts to propose institutional designs for surveillance and policy dialogue in the region as recommendations for future.

Below analyses and proposals by the five think tanks -- IIMA (Institute for International Monetary Affairs, Japan), IWEPCASS (Institute of World Economics and Politics & Chinese Academy of Social Sciences, China), CSIS (Centre for Strategic and International Studies, Indonesia), AKI (Angelo King Institute, Philippine), and ADB (Asian Development Bank) -- are categorized by topics.

## 1. Introduction

There are three steps for economic surveillance and policy dialogue. The first step is collection and sharing information where transparency is desired, then evaluating macro/financial conditions of member countries comes to the next step. Thirdly, the essential prerequisite for economic surveillance involves “peer review” and “peer pressure”. The appropriate economic surveillance aims to recommend policy reforms to reduce risks and vulnerabilities and go deeper in risk factors.

Economic surveillance is necessary to prevent a crisis, and, if it happens, to manage a crisis better. As regional financial cooperation moves to the creation of an enhanced Chiang Mai Initiative (CMI) -- Expanding the size, reducing IMF-linkage, Pooling of foreign reserves -- all require enhanced surveillance process. Constant surveillance is desired in the case of crisis when the quick decision on releasing funds (if appropriate), and quick distinction between a liquidity crisis and an insolvency crisis is crucial. In terms of regional cooperation, surveillance will make it much more productive, deeper, and efficient, and enhance trade and investment. *[ADB and Angelo King]* It is also important for regional integration. Surveillance will make possible speed up deeper integration.

For efficient surveillance, the region needs a group of experts and support staff (secretariat). *[IWEPCASS]* It should be noted that independence and neutrality have to be guaranteed for the staff and there should be clearly defined objective. The location of secretariat should be considered later.

## 2. Existing Frameworks

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<sup>i</sup> This “Summary of the Summaries” has integrated the executive summary of IIMA’s main report.

The reviews of the existing frameworks begin with the surveillance process under the ASEAN+3. The analysis covers Manila Framework (Nov 1997-2004), ASEAN+3 Finance Ministers' Meeting, APEC Finance Ministers' Meeting, ASEM Finance Ministers' Meeting, EMEAP Governors' Meeting, SEACEN Expert Group on Capital Flows, ASEAN Surveillance Process and ADB REMU and ARIC as supporting Institutions.

Multilateral organizations and other regional experiences are also reviewed. It examines global institutions such as IMF, World Bank, BIS, OECD, G7, G10, G20 and regional institutions as European Union, Inter-American Development Bank (IDB), Asian Development Bank (ADB).

In assessing the existing frameworks and organizations, the study provides criteria for evaluating existing structures. it involves a) expertise: excellent human capital and sufficient resources, b) permanent structure: constant surveillance with consistency, c) No duplication: complementary to existing IFIs, d) independence: independence from member governments; neutrality and objectivity of analysis; fair evaluation and speaking up if necessary, e) close to the market: communicate with the market, f) commitment of members: be serious about recommendation, g) conditional for liquidity support: "carrots" in return.

### 3. Assessment

#### 3.1. IMF

IMF has improved its structure after the Asian crisis. First, data disclosure (SDDS, GDDS, PIN<sup>ii</sup>) was emphasized, and second, strengthened surveillance on the capital markets and financial sector, in addition to macro surveillance was attempted (creating a new Capital Markets Department and introducing FSAP by MAE<sup>iii</sup>). Third, facilities of crisis management SRF, CCL, and PSI (SDRM)<sup>iv</sup> were devised. These movements show that the process of surveillance and crisis management has been evolving at IMF. However, IMF does the best surveillance when the program (financial assistance) is put together.

However IMF is not sufficient for East Asia for four reasons. First, Asian countries are underrepresented as seen in quota and ED chair allocation, staff promotion. Second, influence of the US (and the European countries) is too strong. Third, memory of "wrong prescriptions" has not been cast away. It has little regional expertise while Asia needs counter-balance in voices. Finally, IMF tends to do surveillance bilaterally; some regional surveillance is done, but very weak and ineffective to prevent contagion.

#### 3.2 Regional

The region (group of countries) has a right to have surveillance on themselves, e.g. EU and

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<sup>ii</sup> Special Data Dissemination Standard (SDDS) ; General Data Dissemination System (GDDS) ; Public Information Notice (PIN)

<sup>iii</sup> Financial Sector Assessment Program (FSAP) ; Monetary and Exchange Affairs Department (MAE)

<sup>iv</sup> Supplemental Reserve Facility (SRF) ; Contingent Credit Lines (CCL, terminated in Nov. 2003) ; private sector involvement (PSI) ; Sovereign Debt Restructuring Mechanism (SDRM)

OECD. Regional issues can be reviewed effectively by regional surveillance organizations. The task to be addressed includes a) gains from regional harmonization (taxation, capital controls, investment treaties, custom and quarantine procedures, etc), b) regional insolvency procedure (disputes are often between neighbors), c) regional early warning model (signals may be different for different regions), d) regional ownership.

CMI (ASEAN+3) is weak in several points. CMI (Bilateral Swap Arrangements, BSA) triggers are "bilateral," while CMI (ASEAN Swap Arrangement, ASA) triggers are up to the coordination of chair (opt-out possible). It has to rely on IMF surveillance as long as the 90% disbursement linked to IMF. ASEAN+3 Finance Ministers take participate in the Meeting, however, the chairs are rotated, each country does own surveillance, and Central bank governors are not involved in the Minister-level meetings, although Deputies are involved.

Manila Framework Group (MFG) was terminated in 2004. It is estimated that having no secretariat and broad members from outside the region are not suitable for the region.

EMEAP is the group of central banks. The membership is different from ASEAN+3. Although the heated discussions are developed on creating ABF (Asian Bond Fund) and ABF , it usually does not deliver any announcement nor disclosure of the discussions.

ASEAN Surveillance Process -- ASEAN Surveillance Coordinating Unit (ASCU) in ASEAN Secretariat, Jakarta -- was created at the time of Manila Framework. ASEAN secretariat provides a report and sends out a first draft to deputy/senior official level at the first stage, and Minister level at the second stage. However It has failed to be an effective surveillance unit since no data takes advantage over IMF. It is difficult to get data with the monitoring process remaining informal and peer review by virtue of noninterference principle. There is also a difficulty in workforce; very understaffed (2 economists and 3 staff). *[CSIS contribution]*

ADB (REMU) has well performed in information gathering and early warning system development. Being International organization, with resources in other departments, is a plus. It also submit a surveillance paper to ASEAN+3 Finance Ministers. Although it is understaffed, it can draw on the research and support from the rest of the Bank.

#### 4. Recommendation

The study proposed the following five recommendations. First, regional surveillance process needs to have linkage to CMI. Second, it is expected to invite central bank governors to the ASEAN+3 Finance Ministers' Meeting. Third, it is indispensable to create independent secretariat as centralized surveillance institution. Fourth, gradual steps should be taken toward establishing reserve pooling (or ear-marking). In the event of multilateralizing the CMI, interest will pay for the operating costs of the secretariat (or annual contribution). Finally, it is a good idea to adopt regional CCL (Asian CCL) in ASEAN+3.

Contingent Credit Lines (CCL) was a good idea in the post-crisis IMF reform. CCL is a pre-approved credit line (pre-approved for quick disbursement in the time of liquidity crisis) for a country that applied to IMF for its certification of good standing of the economy and policy. But, it did not become a permanent facility (and was abolished) in the IMF, because

there was no application. The followings are cited as major factors. a) even without CCL, a crisis country can count on a regular facility (program lending, and SRF), b) applying for CCL may send a signal that the country is on the verge of a crisis, c) if economic conditions deteriorate after being certified for CCL, de-listing may happen and that would trigger a crisis, d) CCL commitment fees were regarded as excessively high.

Based on the above lessons, the study contributes how to devise a successful regional CCL. First, applications should be encouraged by creating an advantage of having CCL clearer (lower interest rate; low commitment fee; and promised, quick disbursement). Second, de-listing problem should be mitigated by having de-listing well in advance; or should be done in sequence (like credit rating). Finally, linkage to IMF should be minimal. However, having SDDS, GDDS, and PIN in IMF should be pre-requisite.

The study explores functional criteria for a secretariat. The first point is “independence and fairness.” Governance should be designed to be independent without afraid of being vocal on tough issues. The second criterion should impacts on national policy. Recommendations of the secretariat should be taken seriously so as to reduce vulnerability and risks. Thirdly, resources should be funded substantially and also sufficient number of staffs need to be hired. Forth point is location. It has to be close to the market, having dialogue to the private sector, location near a financial center is desirable. But, some of the above conditions are contradictory. The study further attempts to suggest options on the secretariat questions.

The study further gives analysis on locational criteria for the secretariat. For choosing location, it is important that a host city has convenience and amenity of a major city. In particular, highly-serviced airports, low communication costs, safety and highly educated population, from which support staff can be drawn have to be procurable. Host country should offer additional financial assistance, if necessary, for example rents of the office.

#### Secretariat Question; who and where

Option 1 is to make use of ADB-REMU (Manila) or ADBI (Tokyo). It is noted that REMU has developed an Early Warning System, and has provided a surveillance paper for the ASEAN +3 Finance Ministers’ Meeting. The ADB-REMU is understaffed, although it can draw on the rest of ADB. The ADB Board has a diverse structure of shareholders as a regional development bank. Therefore, in order for ADB-REMU to continue to be an independent surveillance unit for the ASEAN+3, it has to overcome potential criticism that a section is focused only on a subset of member countries; and that the ADB has to be subject to the interest of all shareholder countries.

Option 2 is to expand ASEAN Secretariat to become ASEAN+3 (Jakarta). Organization has already existed, but it would be required to abandon noninterference principle, to accept more diverse base of staff, to reflect voices from the Plus 3 countries. Underfunding and understaffing would have to be corrected.

Option 3 is to establish Plus3 secretariat (Seoul, Shanghai, or Tokyo). It will carry out joint analysis and mission with the ASEAN Secretariat. This can be good starting point as long as the Plus 3 countries coordinate with each other to establish this secretariat. Or it is possibly proposed that they could develop ADBI to be a secretariat for the Plus 3 Counties.

Option 4 is to establish New ASEAN+3 Secretariat (Bangkok, Kuala Lumpur, Seoul, Shanghai, Singapore, or Tokyo). This could start as a modest role and develop into surveillance and can be developed in sequence from Option 3 as well. Duplication criticism has to be cleared.

#### Costs and Funding, options

The study estimates eventual form of a secretariat and costs as US\$ 40 million. 200 professional and supporting staff (with benefits) costs US\$ 20 million (200 x 100,000). In addition, rents and operating costs will be US\$ 20 million.

In terms of burden sharing, the study offers following 3 options.

Option 1 is to contribute x% of foreign reserves (e.g., x=0.01%, USD100 billion reserve pooling and interest rate of 4%, then operating income would be USD40million)

Option 2 is Pro rata to GDP size.

Option 3 is share calculation similar to IMF, World Bank, ADB. The calculation result is Japan, 37%, China, 29%, Korea, 8%, ASEAN 26%. [*Kawai and Arai (2005)*]