INSTITUTIONS TO PROMOTE FINANCIAL STABILITY: REFLECTIONS ON EAST ASIA AND AN ASIAN MONETARY FUND

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ABSTRACT

Over the past decade, East Asia has developed a range of forums and institutions for regional policy cooperation. One idea that has been, and continues to be, discussed is a possible Asian Monetary Fund (AMF). This paper looks at some issues about the design of an AMF. It does not argue the merits of such an institution; ultimately, judgment on the merits of an AMF will be a pragmatic decision made with an open mind on a specific proposal.

The paper puts the debate about an AMF in context by examining East Asia's recent experience with regional financial cooperation and international financial institutions and forums. It reviews the literature on what makes for a 'good' institution – one that embodies the preferences of its owners and can achieve its aims under stress and changing circumstances – and explores some general implications for the design of a regional monetary fund. It then sets out ways in which the responsibilities and organisation of an AMF can be designed in practice to ensure that the institution, if set up, maximises the likelihood of its success.

For a regional fund to secure regional stability, it would need effective and independent surveillance and policy dialogue processes, as well as strong enforcement and accountability mechanisms. To reflect East Asia's preference for quick decision-making, minimal bureaucracy and political control, it would likely need to be structured as a secretariat providing independent expert analysis and advice, with the final decision made by finance ministry deputies acting under direction from ministers.

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1. INTRODUCTION

A regional financial architecture has started to emerge in East Asia. It has many dimensions, spanning improved policy dialogue and surveillance, the development and integration of financial markets and systems, financial cooperation to prevent or manage balance of payments crises, and possible cooperative exchange rate arrangements.[1] It is still in its early stages. One aspect of regional financial arrangements that comes up in discussion from time to time is a regional fund or, more specifically, an Asian Monetary Fund (AMF).[2]

There is widespread recognition in policy and academic circles that the way in which institutions are designed and structured determines their incentives and whether they can in fact achieve their aims. This paper looks at some issues about the design of a possible AMF. It does not presume that a regional institution will be set up. Nor does it argue the merits or otherwise of such an institution. Ultimately, judgment on an Asian Monetary Fund will be a pragmatic decision based on a specific proposal, made with an open mind.

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1 See, for example, Asian Development Bank (2004 a,b ed.), de Brouwer and Wang (2004 eds) and de Brouwer and Kawai (2004 eds).

2 For want of a better term, a possible regional fund is called an Asian Monetary Fund in this paper. De Brouwer and Ito (2003) call it, alternatively, an Asian Financial Stabilisation Fund. In the discussions during 1944 for what became known as the International Monetary Fund, the institution was initially called the 'International Stabilisation Fund' by the Americans (Skidelsky 2000: 325).

Rather, the paper seeks to help contribute to the preliminary debate by canvassing some of the key principles that are useful in thinking about the substantive responsibilities of a regional fund and its organisational features. It is by no means an exhaustive commentary on the issue. It aims to look at practical ways to ensure that a regional institution, if it is set up, is designed to maximise the likelihood of its success.

The paper starts with some context. There have been several important developments in regional financial cooperation in East Asia since mid 1997, and these are outlined in Section 2. East Asia now has the financial resources to fund a regional entity. And it is now trialling forms of financial cooperation. An AMF, if it occurs, will emerge out of this experience.

Section 2 also looks at some recent developments in the global financial architecture. The point of this discussion is that East Asia has a fundamental interest in the global architecture but its interests are not adequately represented in global forums and institutions. It is incumbent on the region to exercise its ownership in global forums and institutions; it is, after all, a major shareholder of the IMF. But the region is dissatisfied with its participation rights, and recent proposals (examined in the paper) which seek to limit East Asia's role in global forums even further may produce a counter-productive backlash in the region. This raises the risk of a more inward-looking regional architecture developing. The paper argues that the G-20 is still the best bet for general debate on international financial issues.

In Section 3, the paper canvases the economics and political science literature for some general ideas about the importance of institutions and what makes for a 'good' institution. The ideas that recur in the literature are the importance of incentives and path-dependence. A 'good' institution is one which has clear aims and responsibilities, can achieve its aims under pressure, and embodies the preferences of its owners. The paper explores some general implications for the building of institutions in East Asia.

Section 4 looks at some specific design issues for a possible Asian Monetary Fund. It posits that the primary aim of a regional fund would be to enhance regional stability. It then looks at how possible responsibilities of a regional fund — particularly surveillance and financial support in a balance of payments crisis — can be made consistent with that aim, especially when there is a global institution that has the same objective. Section 4 also looks at a couple of different organisational forms that a regional institution could assume, and explores which of these is most consistent with the characteristics of a 'good' institution.

Section 5 concludes the paper. It summarises the key arguments. It ends with the observation that the evolution of the regional architecture is not pre-determined. In particular, how East Asia engages with the rest of the world and how the United States and Europe engage with East Asia will affect the outcome.

2. SOME CONTEXT

The debate in East Asia on a regional financial architecture has not been occurring in isolation. There are two ways to put the regional debate in context. The first is what the region has done so far in terms of regional financial cooperation since the start of the crisis in July 1997. The upshot here is that regional financial cooperation has some steam behind it. The second is that the nature of, and progress in, the broader international debate on financial architecture may affect the way in which East Asia approaches regional financial cooperation. The less inclusive the global debate is of East Asia and the region's needs, the stronger is the East Asian constituency for regional institutions and solutions.

2.1 Recent developments in regional financial cooperation in East Asia

The debate about a regional monetary fund in East Asia is not new. And the region now has some experience in thinking about, and dealing with, regional financial cooperation. To put the thinking about a possible regional fund in context, this section outlines four specific developments in regional financial cooperation in East Asia.

The first is the region's initial experience with providing funding in a crisis, notably the meeting of the 'Friends of Thailand' in Tokyo in August 1997. Following in-principle agreement on supplementary financing among EMEAP central bankers in Shanghai on 25 July, officials from the larger regional economies — Japan, China, South Korea, Hong Kong, Australia, Indonesia, Malaysia, and Singapore — committed formally at the Tokyo meeting to provide substantial financial support for Thailand to supplement IMF funding.[3]

This meeting was the first time the region agreed to, and actually did, provide substantial funds to an East Asian country in financial crisis.[4]

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3 The funds committed to Thailand by economies in the region were provided to the Bank of Thailand through baht-US dollar denominated swaps by participating Executives Meeting of East Asia-Pacific (EMEAP) central banks. EMEAP central banks include the monetary authorities of Australia, China, Indonesia, Hong Kong SAR, Malaysia, Japan, New Zealand, the Philippines, Singapore, South Korea, and Thailand. The Philippines attended the meeting (and so was part of the 'Friends of Thailand' group) but was not in a position to commit funds. Japan committed US$4 billion, Australia, China, Hong Kong, Malaysia and Singapore each committed US$1 billion, and Brunei, Indonesia and South Korea each committed US$0.5 billion, a total of US$10.5 billion from the region. The IMF provided US$4 billion, the World Bank US$1.5 billion and the ADB US$1.2 billion. The total package was US$17.1 billion. A summary of international financing packages for Mexico, Thailand, Indonesia and South Korea is provided on page 6 of http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_may98/bu_0598_2.pdf.

4 The ASEAN swap arrangement, established in August 1977, pre-dates the East Asian financial crisis. Under this arrangement, the five original ASEAN members agreed to provide up to US$40 million to other members. It has been used four times but it was not used in the 1997-98 crisis.

Besides the IMF, World Bank and ADB, only countries from the region provided direct financial support to Thailand. The United States declined to participate, in part because the Administration was prevented by the D'Amato Amendment from accessing the Exchange Stabilization Fund. The psychological impact of the Friends of Thailand was large: the same time as it revealed the difficulty in garnering supplementary support from outside the region, it showed that the region itself was able to come together quickly and resolutely to provide support for one of its own. In subsequent international financing packages, the region committed US$14 billion to Indonesia (out of a total US$35.1 billion) and US$11.1 billion to South Korea (out of a total US$58.4 billion).

The second development in regional financial integration was the proposal by Japan in late 1997 for an Asian Monetary Fund. Japan's Ministry of Finance started work on a proposal for an Asian Monetary Fund in late August 1997. The AMF was to raise US$100 billion to support adjustment in the crisis-affected economies, with Japan providing half of the funds. Its members were to be the 'Friends of Thailand' group (Hamanaka 2003).

The proposal was opposed because of concerns that a regional fund would apply weaker conditionality in its crisis funding, thereby weakening the authority and leverage of the IMF in advancing macroeconomic and structural reform in the crisis-affected economies. There was also concern that the AMF would be tantamount to a bailout, rather than reform, of some Japanese banks, with funds being directed to distressed sectors (via their banks) in the crisis-affected economies.

The AMF proposal failed because of the opposition of key countries, notably the United States and China.[5] It is significant, nevertheless, because it put the creation of a regional institution for financial cooperation in East Asia on the policy agenda.

The third development was the Chiang Mai Initiative (CMI) of ASEAN+3. Under the CMI, ASEAN+3 governments in May 2000 agreed to set up a system of bilateral swaps to lend foreign exchange reserves between particular countries in the event of a financial crisis. There are now 16 bilateral swaps in place with an aggregate value of US$36.5 billion. The CMI is widely viewed as a useful step in formalising regional financial cooperation.[6] But it is also seen as a first step. There are a number of aspects about the CMI that regional commentators talk about changing, but about which there is not currently consensus among ASEAN+3 countries.[7]

One is the dependence on IMF conditionality for triggering the facility. Under current arrangements, only 10 per cent of the facility is available without IMF conditionality either in place or about to be put in place, and it is only available for a maximum of six months (compared to two years for the component attached to IMF conditionality).

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5 It was also opposed by the European Union, Hong Kong, Australia, Canada, and New Zealand. Hamanaka (2003) argues that China's opposition might be explained less by 'strategic competition' with Japan than by then President Jiang Zemin's forthcoming visit to the United States and China's negotiations with the United States about China's entry into the WTO and its quota with the IMF.

6 See, for example, Henning (2002), Chaipravat (2004), Rajan and Siregar (2004), and Wang (2004). The ADB also provides information on the CMI: see http://aric.adb.org/default1.asp?handler=infocus&switch=73.

7 ASEAN+3 reviewed the arrangements for the CMI in May 2004 and agreed to revisit the issue in a year's time.

Another area of possible change of the CMI would be increasing the amounts available to individual countries under the CMI swap arrangements.

The most that a member country can access under regional arrangements ranges from US$3 billion to US$12 billion.[8] This is well below the speculative positions that were established in individual regional foreign exchange markets in 1997 and 1998 and well below the amounts of the original financing packages.[9]

The final area of possible change would be to multilateralise the CMI system of bilateral swaps. The simplest way to multilateralise a bilateral network is to coordinate activation of the swaps, either on an informal pragmatic basis or under a specific memorandum of understanding between parties to the CMI to consult with other parties when a country seeks to use the swap facility.

Other, more complex approaches to multilateralising the CMI could be taken. For example, the funds available under the CMI could be available under a regional arrangements to borrow, akin to the New Arrangements to Borrow (NAB) of the IMF.[10] Or they could be an actual pool of foreign exchange reserves. This would mean that countries in crisis could probably access more funds from the region than is currently possible. But it also means that limits may need to be set on access to these funds and that effective mechanisms are in

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8 The latter number includes foreign currency swaps of US$5 billion available to South Korea from Japan under the New Miyazawa Initiative. A condition of this particular swap, however, is that the funds cannot be used to defend the won exchange rate.

9 For estimates of some speculative positions in the East Asian financial crisis in 1998, see de Brouwer (2001). The overall notional packages, as mentioned above, were US$17 billion for Thailand, US$36 billion for Indonesia, and US$58 billion for South Korea.

10 Wang (2004) proposes an Asian Arrangements to Borrow.

place to minimise and deal with associated risks.[11] The CMI could also be multilateralised by setting up a regional monetary fund.

The final aspect of regional financial arrangements is the accumulation of foreign exchange reserves in East Asia, especially of US dollar assets. The region now has foreign exchange reserves in excess of US$2.1 trillion, up from US$715 billion at the end of 1996.

While many economies in the region have increased their holdings of foreign exchange, the most spectacular in the past few years are Japan and China, with US$817 billion and US$445 billion at the end of March this year (Figure 1).

This is significant. With this sort of armoury, it is hard to see how the region would be exposed to a play of events similar to that which occurred from mid 1997 to late 1998.[12]

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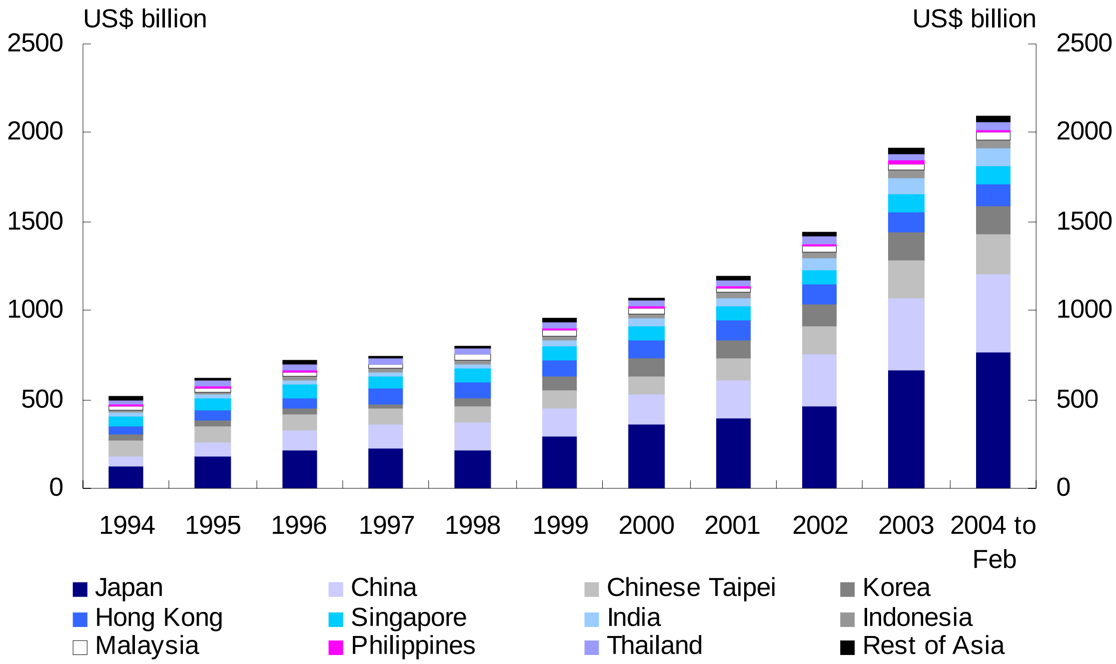
11 See Wang (2004), Chaipravat (2004) and Rajan and Siregar (2004).

12 This is *not* to say that the region is immune from a financial crisis. To the extent that structural weaknesses exist, the region would still be exposed to the risk of a crisis. The enforcement of limits on non-resident access to the domestic foreign exchange swap markets and limited offshore markets in the domestic currency contain speculation by non-residents. But the possibility of speculation by residents and capital flight still remain; see de Brouwer (2001).

Figure 1: Foreign Exchange Reserves of Selected Asian Economies



Reserves of this order naturally lead to the question of how they might be used. Such reserves are not only costly to carry but they also have an opportunity cost which is high for some developing economies. Some countries, therefore, may want to use them for domestic purposes, as China did in January 2004 by allocating US$45 billion of its reserves to fund bank recapitalisation.

But the main holders of these reserves, while probably not wanting to build up reserves further, may keep them on the official balance sheet.[13] As such, some portion of them might be used in some form of financial cooperation. If the region did decide to multilateralise the CMI arrangement, for example, say in the form of an Asian Arrangements to Borrow or central reserve fund, some of these reserves could be hypothecated to that purpose. Amounts that are talked

13 There is an ongoing debate about the sustainability of East Asia's accumulation of foreign exchange reserves. Dooley, Folkerts-Landau and Garber (2003) argue that the process can go indefinitely. Eichengreen (2004) and Park and Yoon (2004) provide persuasive rejoinders.

about in the region range as high as US$100-200 billion, which is substantially above the aggregate value of the bilateral swaps. In this case, Japan is talked about as the most likely candidate to increase the amount of funds in such an arrangement.

The region certainly now has the financial resources to deal with regional financial crises alone if it so wanted. At the end of 2003, the IMF's total resources were US$326 billion but its one-year forward commitment capacity was a more modest US$81 billion; supplementary funding of around US$50 billion is available through the General Arrangements to Borrow and the New Arrangements to Borrow.[14] The catalytic role of external funding for a country in crisis can now be provided by either the IMF or East Asian financial resources. But, at this stage, in the absence of a credible regional surveillance and enforcement mechanism, IMF involvement would probably have the most powerful catalytic role in establishing policy credibility for a country in crisis.

2.2 The international debate

The East Asian debate about regional financial cooperation also needs to be seen in the context of the international debate about global financial arrangements. The global debate has a long history and is clearly ongoing. It focuses on issues of substance about financial cooperation. It includes: the pre-conditions for avoiding financial crises; the amounts, terms and conditions for providing financing in a crisis that are compatible with the desired incentives for borrowers, lenders and financial markets in general; the coordination mechanisms between the official sector and the private sector in dealing with and resolving crises; and technical assistance. And the global debate has increasingly focused on the operation and governance of the forums and

14 See Reserve Bank of Australia (2004).

institutions by which financial cooperation is effected, especially the International Monetary Fund and policy dialogue forums like the Financial Stability Forum, G-7 and G-20.[15]

The global debate is one in which East Asia has a direct interest and is active. The region participates in a variety of ways.[16] Japan is the only East Asian country that is part of the G-3, G-7, G-8 and G-10, and it reports developments back to countries in the region on an informal basis. Japan, Australia, Hong Kong SAR and Singapore are part of the Financial Stability Forum.[17] Japan, China, Indonesia, Australia and South Korea are part of the G-20. Japan, China, Australia and Thailand are also members of the International Monetary and Financial Committee (IMFC) of the IMF.[18] There have also been non-G-7 discussions on the global financial architecture in the region, notably those led by South Korea.[19]

But many in the region are dissatisfied with the debate. In the first instance, most of East Asia is under-represented in the decision-making of the IMF while

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15 See, for example, De Gregorio et al. (2000), the May 2003 American Economic Review Papers and Proceedings discussion on the IMF, Eichengreen (2003a,b), Henry et al. (2003), Vines and Gilbert (2004 eds), and Kenen et al. (2004).

16 A list of forums and their members is available at http://www.imf.org/external/np/exr/facts/groups.htm#G20. Because I am referring to East Asia and not just Asia, I am including Australia but not India. India is a member of the G-20 and IMFC.

17 Japan is represented by the Ministry of Finance, Bank of Japan and Financial Services Agency, Australia by the Reserve Bank of Australia, Hong Kong SAR by the Hong Kong Monetary Authority, and Singapore by the Monetary Authority of Singapore.

18 For two years from November 2004, South Korea will replace Australia on the IMFC because South Korea will lead the shared IMF constituency for that period.

19 See, for example, SaKong and Wang (2000 eds) and Kim and Yang (2001 eds).

Europe is over-represented.[20] This is an ongoing sore point in the region and has become the talisman of the region's discontent. Eichengreen (2003b) regards the need for rebalancing regional representation as one of the basic issues for reforming the governance of the Fund. It is an increasingly widespread view.[21]

And dissatisfaction runs deeper. There is concern that the credibility of the Fund is undermined by its pliability in meeting the short-term strategic objectives of its major shareholder. There is concern that the concentration of the IMF's lending to Argentina, Brazil and Turkey increases the Fund's — and hence its shareholders' — exposure to risk and creates moral hazard. While these are (now) systemically important countries, they are not as strategically important to East Asia as they are to the United States or Europe.

East Asia has a direct interest in the ways that weaknesses in the Fund's governance can be resolved.

There are different views on the ways to do this. Eichengreen (2003b), for example, argues that the IMFC is the natural place to reform the IMF (even if the IMFC itself needs reform).

He argues that alternative forums, especially the G-20, are not ideal because they lack broad support from Europe, especially from the smaller European countries who are members of the G-10 but not the G-20.[22] Yet it is hard to see how these countries could be happy with changes to quotas and representation on the IMF

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20 See de Brouwer (2004: 261). Based on GDP, Europe is over-represented by about 6 per cent in IMF quotas, while the United States and Japan are under-represented by 12 and 9 per cent. The Dutch, Saudi and Belgian constituencies are the most over-represented in terms of IMF quotas.

21 The editorial in the Financial Times of 3-4 July 2004, marking the 60 year anniversary of the Bretton Woods conference, argues that 'financial "quotas" and voting power must be revised to give nations such as the emerging Asians clout in the fund that reflects their economic size' (page 6).

Executive Board and IMFC. From East Asia's perspective, there must be better grounds for rejecting the G-20 than simply because it is opposed by some small otherwise-overrepresented European countries.

Henry et al. (2003) argue that groupings based on the G-7 or G-10 are not balanced globally and hence lack credibility. The IMFC is certainly a key and essential forum for debate and decision. But it has the foot print of the G-10 and hence lacks geographic balance.[23] Henry et al. argue that the G-20 is the better and more credible forum in which to take up these issues, and advance, among other things, reform of the IMF.

Kenen et al. (2004: 43) perceive a shift towards informal groupings rather than formal institutions as the way to discuss and resolve international financial policy issues.[24] They argue for a consolidation of groupings, explicitly recommending closing down the G-10 (pages 94, 98). They advocate reform of the IMF: upgrading the role of the Executive Board; rationalising EU representation; and revisiting the allocation of quotas which determine voting rights (99). And they recommend that the G-20 call for the formation of a new Council for International Financial and Economic Cooperation (CIFEC) to set the global agenda. The CIFEC would be limited to 15 country members (105-6).

The idea of a CIFEC is new and has not yet been fully debated. East Asia is likely to be suspicious of this proposal, for three reasons. It was made by North Americans and Europeans without Asian involvement and consultation.[25] It is

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22 These are Belgium, the Netherlands, Sweden and Switzerland.

23 For example, it has nine European country members, compared to five from Asia (and four from East Asia), five from the Americas, three from Africa , and two from the Middle East.

24 The examples they use are the G-20, FSF, and Basel 2 processes.

25 The authors are eminent North Americans and Europeans and the text contains little reference to the issues or literature from East Asia. Contrast this, for example, to the

unclear who are the 15 members that the authors have in mind. The concern in this case would be that it would wind back further the gains in East Asian representation that were made in the G-20. And it is the creation of yet another forum when there is already a plethora of them (although there is no net increase in forums because the G-10 would be disbanded). The Council, by its name and function, would be a paramount forum. All in all, from East Asia's perspective, the CIFEC might be seen as a proposal made by those outside the region without consultation with the region, for a new and powerful forum which would likely reduce East Asian participation and voice in international economic and financial policymaking.

It is worth noting here that the G-20 itself was a compromise that cut back a key gain in East Asian international participation and voice. The G-20 was set up by the G-7 after the experience with the G-22, also known as the Willard Group.[26] The G-22 was an initiative of President Clinton at the APEC meeting at Vancouver in November 1997. The success of its three working groups on international financial crises, strengthening financial systems, and transparency and accountability in the aftermath of the financial crisis showed the value of fresh, practical and less institutionally based dialogue and cooperation.[27] But its provenance and inclusion of so many East Asian countries made it unacceptable to the Europeans.

The G-20 carries the same membership as the G-22, adding Saudi Arabia and Turkey but dropping Hong Kong SAR, Malaysia, Singapore, Thailand and

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geographic balance in the monograph on IMF reform by De Gregorio, Eichengreen, Ito and Wyplosz (2000).

26 Its members were the G-7 as well as Argentina, Australia, Brazil, China, Hong Kong SAR, India, Indonesia, Malaysia, Mexico, Poland, Russia, Singapore, South Africa, South Korea, and Thailand.

27 The three working group reports are available on the websites of the IMF, World Bank, BIS and OECD.

Poland. Given the region's experience with the metamorphosis of the G-22 into the G-20, East Asia is naturally wary of further changes that would weaken its participation in international economic policy dialogue. The view from East Asia may be that the effort should be in making the G-20 work rather than setting up another forum.

This context is important in understanding the pressures for further change in regional financial cooperation in East Asia. The more the region is dissatisfied with global arrangements and feels that it is marginalised in, or excluded from, international policy debates, the more likely it is to focus on regional solutions. This is a process which has the dangerous potential to spiral and feed back on itself. There is a need for better engagement of North America and Europe with Asia on these issues and vice versa (a point I will come back to in the conclusion).

The onus is also on East Asia to make the case for change. By using the voice it does have in a range of forums and behind the scenes, East Asia can strengthen its case for wider representation in global forums. This entails, among other things, the region forming its own views on the global financial architecture and projecting them in key forums. This is work-in-progress. East Asia's authority would be enhanced by showing that it is not only seeking to advance its own interests but also secure outcomes which improve global wellbeing.

3. THE DESIGN OF INSTITUTIONS

Before going on to look at some specific issues about the design of a possible Asian Monetary Fund, it might be useful to introduce the material by highlighting some of the key (rather ethereal) insights from the political science and economic literature on the design of institutions. There are two elements that are worth noting here. The first is the importance of institutions and getting their design right. The second is the set of characteristics that make for a 'good' institution.

3.1 The importance of institutions

There is widespread recognition that institutions are important. Goodin (1996: 23), for example, argues that the basic value of institutions is that they provide stability and reliability by enabling a nested system of rules to govern current and future behaviour. In this respect, they can provide more certainty about the future and hence improve predictability and reduce risk. And because transactions are not costless, institutions matter.

North (1990: 107) makes the powerful assertion that institutions 'are the underlying determinant of the long-run performance of economies.' The recent works of Hall and Jones (1999), Caballero and Hammour (2000) and Acemoglu, Johnson and Robinson (2004), among others, are attempts to support this claim. These works argue that economic institutions embody a set of incentives in the economy, and that these incentives 'are the underlying determinants of economic performance' (North 1990: 135).[28] Incentives and institutions can also vary considerably over time.

Institutions lock in, and set a future path for, sets of relationships, forms of action, and responses to events.[29] Because of this path-dependence, the incentives and behaviours embodied in institutions are carried forward: the decisions of today affect what happens in the future. Moreover, the creation of a new institution induces its own responses, a new set of constraints, and persistent informal and formal rules that will govern and influence future behaviour (North 1990: 83).

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28 See also Brennan (1996).
29 George Soros calls this 'reflexivity'.

In this context, 'institutions' are defined broadly as 'the rules of the game in a society or, more formally, … the humanly devised constraints that shape human interaction' (North 1990: 3). North's definition of institutions includes bricks-and-mortar institutions, as well as the broader systems of networks and interactions between people and groups in the economy.

There are three implications from this type of analysis for setting up a new institution like an Asian Monetary Fund. The upshot of them is that setting up a new institution is not something to be taken lightly.

In the first place, it is essential to get the incentives and the structure of the institution right. If poorly designed, then not only can an institution do damage but, because it creates its own set of interests in its preservation, it can be hard to undo or correct the damage. There are learning costs in setting up a new institution which need to be managed and which should enter the cost-benefit analysis of setting the institution up in the first place. And, looked at from a broader perspective, to the extent that the current focus on regionalism is (at least in part) transitory — part of a cycle or long oscillating wave between globalism and regionalism — it is important to ensure that setting up a regional institution does not lock East Asia into a set of regional solutions without ready recourse to global solutions at some later stage.[30]

Second, given that institutions are devised from the self-interest, circumstances, and particular 'transactions costs' existing at the time,[31] there is no presumption that an institution created for the needs of East Asia at this point in time will necessarily have the attributes of some other similar institution elsewhere. In other words, what suits the region should be informed by insight from

30 Kenen et al. (2004) present an interesting commentary on the waves of policy dialogue and cooperation in the post-war period.

31 See North (1990: 48).

elsewhere, but it does not necessarily have to mimic what is done elsewhere. The mind should be full but the paper blank.

Finally, practical policymakers should focus on the substance and effectiveness of institutional arrangements and not just the form that they may take. There is an array of different types of institutions, ranging from informal networks to 'bricks and mortar'. Formal institutions might not be the most effective type of institution for the issues at hand; flexible relatively informal arrangements may in fact deliver better results than formal rigid ones. East Asian policymakers might end up deciding that a 'bricks and mortar' type AMF is the right way to go, but they should not feel compelled to think that that route is the only, or indeed the best, way to indicate their support for regional financial cooperation and community building.

3.2 What defines a 'good' institution?

Given that they are important, what makes for a 'good' institution? There are four aspects that emerge from the literature, with varying degrees of specificity.

The first is that the responsibilities of the institution have to be well defined; it has to have a clear sense of its mission (Wilson 1989; Tirole 2002). This is not as anodyne as it sounds. The staff and management of an institution need to have a practical understanding of its function, and an institution's oversight body needs to have some terms of reference to judge performance. Governance is harder when an institution has multiple and competing objectives.

The second is that the institution needs to be robust to pressure. It needs to be able to meet its stated purpose under internal and external pressure. A crisis-management institution has to be able to operate under the pressures of a crisis. The pressures may come from politicians and the political process. This implies that some independence from the political process is necessary, at least in terms of the analysis of, and advice about, economic and financial vulnerabilities in the region.

The pressures may come from the particular national interests of big countries within the region, especially if the region comprises a few very large countries, as does East Asia. This means that decision-making may have to be shared across countries. The region as a whole will be reluctant to choose institutional forms or practices which allow a big country to dominate a regional institution in the same way as the United States is perceived to dominate the IMF.[32] And pressures may arise from outside the region — in East Asia's case, this is principally the United States. This means that effective communication channels have to exist across regions, not just within them.

The third element of a 'good' institution is that it embodies the preferences of its members/owners. It is hard to identify common preferences for a region as heterogeneous as East Asia, and the assessment that follows is subjective and tentative. But, given that caveat, three strong preferences can be identified. They are preferences for: a simple and streamlined process with minimal bureaucracy; retaining political control over decision making to ensure that, while guided by technical advice, decisions are under political control; and promoting harmony and community building in the region, which means balancing the interests of big and small countries in the region and of North and South East Asia.

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32 While the region has some frustration with US veto power in the IMF, the United States is not the only shareholder with veto power. Coalitions in excess of 15 per cent of voting rights have formed at times in the IMF and have exercised veto. It is open to European and East Asian constituencies to form coalitions to do so.

In terms of crisis management, its experience with the 1997-98 crises means the region wants to be able to make decisions quickly in a crisis. Section 4 looks at ways to accommodate these preferences in the responsibilities and organisational design of a regional fund.

And it is not enough that an institution just satisfies the short-term needs of its owners; it needs also to meet the basic preferences of its shareholders in the long-run. A relevant example of the importance of time-consistency is the IMF's recent experience with lending to Argentina. The provision of funds by the IMF prevented an immediate crisis but it came at the expense of moral hazard for Argentina and a concentrated country-exposure by the Fund, both of which potentially undermine international financial cooperation and stability.

The final element of a good institution is really a set of micro conditions relating to flexibility. Goodin (1996) argues that well-designed institutions need to be flexible enough to change as the circumstances change ('revisability'). They need to be flexible enough to deal with complexity in terms of agendas and motives. And they need to be flexible in dealing with new situations, experimenting, and trying new ways to get things done. Openness to the rest of the world can help promote flexibility.

At times a trade-off may exist between some of these conditions for a 'good' institution. For example, there may be occasions when the various intense pressures that emerge during a crisis challenge the regional institution to remain fully consistent with the preferences of its owners. How the conflict between goals is achieved may depend on the organisational design of the institution. For example, an independent advisory body within the organisation may be a practical mechanism to help decision-makers resist some of these pressures.

4. THE DESIGN OF A POSSIBLE AMF

The design of a regional institution covers two basic areas. They are the responsibilities of the institution and its organisational structure.

4.1 Possible responsibilities of an AMF

The pivotal rationale for a regional entity is to ensure stability. The guiding principle for selecting the responsibilities of an AMF, therefore, is that the institution should promote regional financial and economic stability in a practical fashion. It can do this in two ways:

- by seeking to reduce the risk of crises occurring; and
- by providing funding to prevent or minimise a crisis.

The second of these methods may be linked to the first. For example, increasing the pool of financial funds available to deal with a crisis may be a way to reduce the likelihood of the crisis if it is a credible demonstration of the fundamental strength of the economy concerned.[33]

33 See, for example, Corsetti, Dasgupta, Morris and Shin (2000) for a model which associates higher reserves with better economic fundamentals.

But if it is not credible, it may just serve to increase the size of the bets, and instead of reducing the risk of a crisis it may even exacerbate it.[34]

In thinking about the scope of activities that are compatible with the aim of promoting regional stability by a regional institution, it is natural to consider them in comparison with what the IMF does as a global institution responsible for global stability. The IMF has four main functions: surveillance of the global economy and the economies of its members; the provision of technical assistance to its members; an international forum for consultation and collaboration on international monetary problems; and, finally, lending to its members (Fischer 2003).

At least in some respects, the responsibilities of a regional institution cannot mimic those of a global institution. A regional body, for example, cannot do global surveillance or facilitate global collaboration itself. And there are some forms of cooperation that probably can only be done at the global level. Private-sector involvement (PSI), for example, requires global coordination to be effective. East Asian governments have no jurisdiction over the activities of US or European banks and other financial institutions outside East Asia.

But even if the regional cannot mimic the global, a properly designed regional institution might echo some of the functions of the global institution.

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34 The speculative short positions of the macro hedge funds in the Asian financial crisis, for example, were larger, the greater was the willingness of the authorities to defend what the macro hedge funds judged to be an indefensible exchange rate. The short positions on the baht in 1997, for example, were larger than those on other regional currencies (apart from the yen) in either 1997 or 1998 (de Brouwer 2001). These select hedge funds faced no constraint in borrowing from banks and other financial institutions, giving them greater freedom to increase their short positions as they wanted. In some instances, increasing the amount of funds to defend a particular financial price may just have raised the stakes in the speculative game and not have prevented the crisis. The counter-factual is unknowable.

The literature looks at the responsibilities of a *regional* body in terms of surveillance, collaboration and crisis funding at a *regional* level.[35] Parts of the literature also discuss the possible role of a regional fund as coordinator and manager of regional cooperative exchange rate arrangements. Consider these in turn.

Surveillance

Effective surveillance is uniformly regarded as one of the lynchpins of financial stability. It is an essential part of reducing the risk of crisis. And it is a prerequisite for the provision of crisis funds. There can be no financial cooperation without it. Effective surveillance requires not just the sharing of information about key economic and financial developments but also frank and open discussion, albeit behind closed doors, of policy responses to the economic and financial issues in play.[36]

There is a large body of opinion that East Asia has too little effective regional surveillance and collaboration.[37] This is multi-dimensional. Given that much of East Asia comprises developing economies with diverse income levels, the region faces a basic problem of adequate data and information collection and exchange. There has been considerable work in recent years on improving data systems, through the work of the IMF, ADB and other agencies.

Commentators also talk about a lack of frank and critical dialogue on policy issues in the region. There is some reticence to cause offence or criticise others,

35 The discussion here does not take up the issue of technical assistance. Technical assistance already exists at the bilateral, regional and global level.

36 This is true for regional and global surveillance; the IMF biennial reviews of surveillance and reports of the IMF Independent Evaluation Office are an indicator of how seriously this is taken.

37 See, for example, Bergston and Park (2002), Wang and Yoon (2002), Grenville (2003), Kuroda and Kawai (2004), de Brouwer and Wang (2004).

especially potential providers of funds, and to be open about domestic problems. The ASEAN principle of non-interference in the internal affairs of other countries can lurk in the background when discussion turns to sensitive issues. Nevertheless, the region is aware of the need to develop 'frank and open exchange' and is working to improve it.

There is considerable scope for 'learning by doing', as policymakers in East Asia experiment with different ways of talking about issues. These include the use of independent or academic trigger speakers, secretariat staff, independent chairs, and peer review.[38] Some of these may work better than others. 'Outsiders', for example, can play a useful catalytic role in discussion, at least early on, by providing analytical insight and raising sensitive issues. Given the economic imbalance between countries in East Asia, it is hard to see how peer review can produce effective surveillance. How, for example, can the region's small transition economies address the economic issues facing the region's big industrial economies? And how willing are the big countries of the region to be assessed by the smaller countries?

The case for enhanced regional economic policy dialogue in East Asia is powerful. East Asia is a rapidly growing, increasingly inter-connected economic region, with markets, institutions and regulatory systems of varying strength. Substantive and frank policy dialogue not only helps policymakers understand better their mutual dependence, but is a tool to articulate practical policy responses to the issues they face. It can provide ideas and help create a constituency for a particular policy or reform. Dialogue can also be a way to soothe bilateral tensions or sort out thinking on how developments elsewhere affect countries in the region and the region as a whole. Regional dialogue can

38 Suggestions are made, for example, by Wang and Yoon (2002), Balls (2003), and de Brouwer and Wang (2004).

be a forum to flesh out regional approaches and coalitions for wider global reform.

The aim in the region is to achieve something like the level of debate of Working Party 3 (WP-3), a policy dialogue forum of the 10 largest industrial countries held under the auspices of the OECD (Ito and Narita 2004). The history of WP-3 is instructive. It was set up in the early 1960s as a forum for the larger OECD countries to discuss monetary and balance of payments problems. In the early 1960s, for example, it was the forum in which the Europeans talked about the US balance of payments deficit and United States talked about the underdevelopment of European capital markets (Solomon 1982: 42).

From the start, WP-3 was also a forum in which the largest industrialised countries discussed international financing arrangements, including terms and conditions for access to IMF funds and establishing the General Arrangements to Borrow (GAB). To quote Solomon (43): WP-3 'and the deputies of the Group of Ten would play an important role in the decisions whether or not to lend to the Fund and how to apportion any loan among participants. In deciding whether or not to lend to the Fund they would, in most cases, also be determining whether the Fund would be in a position to lend to any country in need of financing.' Not surprisingly, '[s]ome other members of the Fund found this arrangement less than pleasing' (Solomon:44).[39]

There are three points from this. Surveillance and policy dialogue in the WP-3 was, and is, substantive and frank. From the start, industrial-country surveillance was tied to industrial-country crisis lending arrangements. And from the start, industrial country surveillance was outside the IMF (even if it

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39 To continue the quote: '[T]he Australian Director spoke of a "very exclusive club" and the Indian Director feared that the Fund Board might find itself obliged to concur in decisions taken elsewhere.'

also involved the IMF Chief Economist as chair of the meeting). Indeed, at the IMF Executive Board discussion on this matter, 'the Dutch Director described the [GAB] agreement as a compromise between the ideology of the Fund as a global monetary institution and a newer ideology which sought solutions through closer cooperation between the main industrial countries' (Solomon: 44).

Financing

It is probably appropriate, at this point, to turn to thinking about possible principles for determining financial arrangements in a regional fund. As discussed in Section 2, East Asia now already has a regional mechanism for financial cooperation, the CMI. The issues that arise with respect to review of the CMI are attachment to IMF conditionality, the sufficiency of the amounts available to individual countries, and whether the bilateral arrangements should be multilateralised in some form. They also appear in the debate about a possible AMF.

The need for regional financing is well-accepted. The IMF's financial resources have always been limited and the need for 'outer perimeter defences' has been recognised for over 40 years since the creation of the GAB in 1961.[40] As expressed in the above quote by the Dutch Director of the IMF on the GAB, it has long been recognised by the major powers that cooperation outside the IMF can be consistent with the IMF. This has resonance in East Asia. In the 1997-98 financial crisis, especially for Thailand, countries in the region were a — if not the — major source of funds. While supplementary funding is available through the GAB and NAB, triggering them depends on the agreement of regional outsiders and can take time.

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40 Solomon (1982: 42-3) attributes this term to Robert V. Roosa, US Under-Secretary of the Treasury for Monetary Affairs in the late 1950s.

And the general basis on which financing is provided is also well-accepted. Funding is provided to support adjustment for countries experiencing short-term balance of payments difficulties. This has always been the basis for IMF funding. In their monograph advocating an Asian Monetary Fund, Bergsten and Park (2002) carefully use the same language in relation to a regional fund. This is intentional: it highlights that a regional institution is for managing the external dimensions of financial crises, and not for the general lending or transfer of funds between countries or for supporting domestic financial institutions (although that still remains open at the bilateral level).

The debate is not on the need for supplementary funding for balance of payments difficulties but rather the arrangements under which it is provided. I do not focus in this paper on technical issues like limits to access, triggers for funding, rules for disbursement, reporting arrangements and transparency, and the role of countries outside ASEAN+3 in an East Asian fund. These are clearly important but might be thought of as details to be worked out if there is agreement to set up a regional fund.[41] Rather, the focus is on the basic prerequisites for a well-functioning regional fund. In this respect there are three core issues to examine: surveillance and conditionality; enforcement mechanisms; and the relationship between a regional entity and the IMF.

The need for surveillance has already been discussed. But the institutional framework in which it is delivered has not been. Objective and high-quality economic analysis is needed if a lending agency is to reduce the likelihood of instability; the difficulty, as Eichengreen (2003b: 29) argues, is to ensure that 'staff … have the independence and insulation from internal pressures to call a

41 And some of these issues are still ongoing ones for the IMF; see the discussion in Eichengreen (2003a,b).

spade a spade'.[42] One way to resist the many pressures to compromise assessments and advice would be to locate the surveillance function in an economic office which would be independent of those who make the decision to lend. I return to the organisational aspect of this later. It is also essential to have high quality analysis. This means it is necessary to staff the economic office with highly qualified and experienced economists from the region and beyond.

Regional financing arrangements require appropriate terms and conditions. This is met in the CMI by a detailed contract signed by both parties to the bilateral swap agreement setting out the mechanics for using the facility and the requirement for IMF conditionality (either actual or expected in good faith). The region might decide to continue relying on IMF conditionality if it set up a regional fund. In this case, setting up a regional fund would simply be a device to formalise 'Friends of Thailand'-type financial cooperation. Indeed, Bergsten and Park (2002: 17) do not seem to envisage independent conditionality, arguing that 'a regional financial arrangement could rely on the IMF for designing and enforcing policy conditionality to be imposed on borrowing countries.'

The region might decide to substantially ease or remove the attachment to IMF conditionality. This would then require it to set out its own economic and structural conditions for the putative borrower to access the region's funds. As is widely appreciated in East Asia, to fail to do so could create substantial moral hazard. This would require careful analysis beforehand of what conditionality is necessary in dealing with a crisis. Is it restricted to monetary and fiscal policy settings? Or does it also extend to particular financial and structural policies and, if so, which ones?

42 See also Balls (2003) for a discussion of these issues with respect to the IMF.

The prospect of independent conditionality in a regional fund invariably leads to the raising of issues such as crisis-management arbitrage (the 'race to the bottom' to 'lowest common denominator conditionality'), the lack of reputation and credibility of a new institution, and risk of inconsistent monitoring (Tirole 2002). These are serious issues. But they are also ones of which East Asian policymakers are aware. Creditor countries in East Asia have no desire to waste public resources.[43] It really is not possible to say *ex ante* that conditionality set by a regional body would be weaker than that provided by the IMF, or that a regional body would be less credible than the IMF. It depends on perceptions about the quality of economic analysis, policy debate, and incentives in the region; see de Brouwer (2004: 272-7) for a more detailed exposition. Again, the credibility of a regional fund depends on the strength of its surveillance and independence of its assessment and advice. This is why a primary focus in financial cooperation in East Asia in recent years has been on improving policy dialogue.

There is an associated issue of the enforcement of terms and conditions. It is one thing to have appropriate terms and conditions set out in lending documents. It is another to enforce them in a crisis under intense internal and external political and commercial pressure. Again, this is not just a potential problem for a regional fund; it is also a problem for the IMF, as recent experience shows. This is complicated further by the need to retain flexibility in selecting and enforcing conditionality as the economic and political situation progresses (again, as the evolution of Letters of Intent in IMF-managed crises shows). The attraction for creditor countries of the CMI arrangements as they currently stand is that they effectively delegate enforcement to the IMF; the IMF suffers the opprobrium and

43 Japan, for example, declined informal requests from Thailand and South Korea for bilateral funding to supplement their foreign exchange reserves in 1997 (de Brouwer 2004a).

lender countries do not directly expose their bilateral relationship with borrower countries to the pressures unleashed by enforcing the terms and conditions on lending.

There are mechanisms that strengthen incentives on lenders to enforce conditions on borrowing. One is to use the head of the regional body or institution as the interface with the borrowing country. In this case, appointing an influential, powerful, respected and impartial person as leader is essential. The regional institution could subject itself to scrutiny through, for example, the publication of the independent analysis of its economic office, the creation of an independent office of review, or the use of the IMF or its Independent Evaluation Office as an agent for performance assessment.[44] Public scrutiny, through independent media and financial markets, can also provide a powerful discipline on ensuring that lending conditions are being met. Ultimately, if countries are not willing to enforce conditionality, then an AMF would likely increase the risk and severity of crises in the region.

The final issue on regional financial cooperation is the relationship of a putative regional body with other international financial institutions. The significant 'other' is the IMF.[45] If an AMF is purely an associated financing agency of the IMF, then the question of space between institutions does not arise. If an AMF has substantial independent financing capacity, then the crucial issue is avoiding gaps in the management of financial crises.

Parkinson et al. (2004) explain this risk in more detail. The gist is that if a regional entity starts as the 'lead' manager of a financial crisis in the region,

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44 The creation of an independent office of review is unappealing since it would be both expensive and create more bureaucracy than the region probably wants.

45 See Henning (2002: 68-74; 77-84; and 93-5) for a discussion on East Asian regional financial cooperation and the IMF.

there has to be an effective mechanism to pass management of the crisis to the global crisis manager if the crisis becomes unmanageable at the regional level, say, because it extends to many other countries in the region or spreads beyond the region. This means that a regional institution, even if it is independent, needs to be compatible with, complementary to, and underpin global mechanisms.

Even if a regional fund is independent of the IMF, there have to be effective and strong links between the two institutions. These links need to be formal, say by requiring regular meetings to discuss recent developments and issues, extensive staff exchange and interaction, and perhaps even involvement of each institution in discussions on possible lending. The WP-3 has always been closely connected to the IMF even if it is independent of it. And the links need to be informal, with close and respectful working relationships. It is important in this case to avoid the damaging aspects of competition that emerge at times between other regional and global institutions (like the development banks). One way to secure mutual respect is for the regional institution to develop and show particular expertise in the analysis of East Asian economies and systems, and for the IMF to listen to the insights about East Asia from the regional entity.

Exchange rate management

The third set of functions that are discussed in East Asia as a possible responsibility of an AMF is reserves and exchange rate management (Bergston and Park 2002). If the region were to decide to pursue a cooperative exchange rate arrangement, such as targeting a synthetic Asian currency unit or basket peg, then it would need a process to organise and coordinate exchange rate management. This paper does not canvas the arguments for and against coordinated exchange rate arrangements in East Asia.[46] At this stage, there is

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46 There are now many papers on this. See, for example, the references in Bergsten and Park (2002), de Brouwer (2002 ed.) and de Brouwer and Kawai (2004 eds).

little support for intermediate cooperative exchange rate arrangements, although there is a broader ambition for currency and monetary union in East Asia, at least in parts of it, in the long run.

The implications of the debate on regional exchange rate arrangements for a possible AMF are twofold. Ultimately, ongoing deep cooperative exchange rate arrangements need some institutional backing, especially if they are an interim step to currency union. While the BIS could perform some of these functions, it is not owned by the region. And while the ADB would like to perform this function, doing so would appear to exceed its charter. An AMF might be the right institution if the region were to pursue cooperative exchange rate arrangements.

The second is to ensure clarity in the functions of a regional institution. The function of exchange rate coordination (and implicitly reserves management) is distinct from the function of crisis prevention and management (although, of course, the selection of exchange rate regimes can matter for susceptibility to a financial crisis). This distinction would need to be embedded in the design and structure of the institution. If the region went down this route, funds for dealing with financial crises would need to be separate from funds to support exchange rate parities.

There should also be some independence of the sets of countries which would participate in each of these two activities of the regional fund: participating in the financial cooperation function of an AMF should not necessarily imply participation in the exchange rate coordination function.

4.2 Possible organisational structure of an AMF

The other basic design feature of a putative regional fund is its organisational structure. The (rather long and stacked) question posed here is: given the current state of technology in communications and travel, given our experience with the behaviour of institutions and the importance of governance, and given the general preferences of the region for bureaucratic simplicity and political control, what sort of organisational and governance structure would best deliver an effective institution for regional stability?

There are three guiding principles in thinking about organisational structure. The organisation should be:

- able to make decisions sufficiently quickly. Crises evolve quickly, so it is important to have a structure which enables decision-makers to confer and act quickly.
- directly representative of regional interests. The various national interests within the region should be reflected in the assessment and decision making of the institution in a balanced manner.
- simple and streamlined. The decision-making process should be as simple as possible, and not be overburdened by excessive and costly bureaucracy.

What do these principles mean in practice for the design of a possible AMF? One way to assess this is to look at existing institutional models. There are two models that stand out. The first is the (Harry Dexter White) IMF model of an institution with a large independent bureaucracy which provides independent expert analysis of the issues, makes recommendations, and makes decisions overseen by an on-site body representing the owners of the institution.

The second is the Bank for International Settlements (BIS) type-model or quasi-Keynes-IMF model of an institution which provides independent expert analysis of the issues and secretariat support, but leaves actual decision making to a group of senior officials from the core national institutions concerned (in the

BIS case, central banks). In the case of a regional fund, the decision-making body would be a meeting of finance deputies from the member countries, advised by a regional fund secretariat.

This is a quasi-Keynes model because while Keynes wanted decisions of the IMF to be made by national officials, he wanted those decisions to be based on technical rather than political grounds — as argued below, this is probably not feasible. Keynes argued that the governing body of the IMF should be 'made up of high national officials (Treasury ministers or their deputies), who would travel to headquarters periodically to take key decisions, rather than a standing executive board that would meet in continuous session' (Eichengreen 2003: 5).[47]

The choice of model can be informed by the principles outlined above (which in turn embed the preferences of policymakers in the region). The arguments probably stack up in favour of a BIS-type model. There are three steps to reaching this assessment.

The decision to provide lending in a crisis is one that must be made at the political level because, at its core, it involves national judgments about international economic and strategic relationships and possible fiscal commitments.[48] High-quality technical advice is necessary to inform the decision, but the decision is not ultimately just a technocratic one. This means that national governments in the region should retain control of the decision-making process.

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47 In order to minimise the likelihood of the Fund being captured by its local host, Keynes also proposed that the institution not be based in Washington, D.C. See also Skidelsky (2000: 345-6, 465-7).

48 Fischer (2003) makes a similar argument.

National governments can make these decisions directly. They do not need to make them indirectly by passing responsibility to officials in an institution or to a board that is specially constituted to make decisions for them.

This eliminates the possibility of management making decisions with which the majority of governments in fact do not agree.[49]

National governments can make these decisions directly through meetings of deputies for finance ministers. Senior officials from the region can easily meet in person or by using tele/video-conference facilities. Regional proximity and the high quality of contemporary transport and telecommunications technology mean that officials can meet to decide issues among themselves without proxies. This is different from the situation that existed 60 years ago when the Bretton Woods institutions were established.

In making their decisions, the governing body of an AMF would also need specialised advice. While finance ministers and their ministry and central bank officials will have considered views on these matters, it is also important to have a vehicle which can develop expertise in surveillance and crisis analysis, as well as bring national views together and provide independent critical analysis. To this end, an independent management with an economic office to provide analysis and a forum for debate and decision making is essential (even if it itself does not have voting power). Having an independent advisory body might also provide decision-makers with a mechanism to shelter them, at least to some extent, from the pressures in the heat of a crisis to compromise decision-making.

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49 This is a bit controversial. Reflecting on his experience as First Deputy Managing Director, Fischer (2003a) argues that management of the Fund cannot make decisions without the support of the Executive Board. This may be right in general but it is not so in all cases. The Executive Board is sometimes brought late into the decision-making process, after senior management has already announced to the press that agreement on a package to a particular country has been reached or is imminent. A case in point was the 1998 package for Russia. In this instance, the Executive Board felt it had no choice but to support management, even though a number of Board members had serious reservations with the package.

The upshot is that regional preferences would seem to dictate that a regional fund in East Asia should keep its bureaucracy at a minimum. It should have a decision-making process which is as simple as possible, and which makes finance ministers (in the person of their deputies) the core decision makers. But if the decision-making body comprises officials from the national level, the advice given to it should be regionally focused and be as independent as possible. One way to secure the distance needed between the provision of expert analysis and surveillance and the application of that advice, is to ensure that the management of a regional fund and its office of economic analysis be independent.

There are two additional issues that are of importance to East Asia. One is voice. Given the region's concerns with the dominance in the IMF of its biggest shareholder, it is likely that the region will in turn be sensitive to dominance of a regional fund by the big countries of East Asia. There are a number of ways to deal with this. One would be to allow all East Asian countries which are members of the regional fund to participate in decision-making; countries would not be required to participate but would always have the option to do so.[50] Another way would be to expand membership of the regional fund to countries in the wider East Asian region or even beyond it. Countries could also be given voting rights of one country, one vote. The alternative of voting on the basis of country size or financial contribution would mean that the institution would be dominated by Japan and perhaps China.

50 This is different to the proposal of Kim et al. (2000) that the decision-making body comprise officials from China, Japan and South Korea and three other member countries on a rotating basis. Their proposal is unlikely to give sufficient voice to the mid-sized and smaller countries of the region.

The other issue is that setting up a formal regional fund requires bricks and mortar. This means choosing a location. This is a vexed issue in East Asia, even now, as the region considers the merits of setting up a secretariat for ASEAN+3. In their discussion on ASEAN+3 secretariat, de Brouwer and Ito (2003: 8) set out three guiding principles for the selection of a location. These might also be applied to thinking about a site for a possible AMF. The first is that it not be seen to be 'owned' by a big country (the 'Brussels solution'). They argue that this effectively rules out China, Indonesia and Japan. The second principle is that it must balance the broad regional interests of East Asia (particularly of the North and South) and not exacerbate intra-regional rivalry, especially in Southeast Asia. The third is that it must have a relatively well developed economy that can provide infrastructure and stability to the region. No location is perfect but, on these grounds (and, as they say, at the risk of alienating everyone else), they argue that Seoul or Bangkok would appear to be the strongest candidates. Whatever the case, meetings need not be restricted to the location of the bricks-and-mortar institution, but could be held in all member countries at some stage.

5. CONCLUDING COMMENTS

A regional financial architecture has started to emerge in East Asia. It has many dimensions, spanning improved policy dialogue and surveillance, the development and integration of financial markets and systems, financial cooperation, and cooperative exchange rate arrangements. One aspect of regional financial arrangements that comes up in discussion from time to time is a regional fund or an Asian Monetary Fund (AMF).

The aim of such an institution, if it were to be set up, would be to enhance regional financial stability. The focus of the paper has been to think about what this means in a practical way for how the responsibilities of such an institution should be structured and how its organisation should be designed, to ensure that its incentives are consistent with its aims and responsibilities. It does not presume that an AMF will be set up. And it does not argue the merits or otherwise of an AMF. Ultimately, judgment on an AMF rests on the specific proposals made by policymakers.

There is a lot more awareness now, in both official and academic circles, of the need to get the design of institutions right. If new institutions are to be set up, it is important that they end up doing what they were intended to do. As the literature on institutional design points out, there is a risk that any new institution may, under unforeseen pressures and circumstances, not deliver on its promise. To reduce this risk, careful thought has to be given to devising mechanisms and structures that are consistent with the aims and incentives of the institution and shareholders' preferences. This applies to a possible AMF, as indeed it does for any institution.

Likely responsibilities of a regional institution like an AMF would cover economic policy dialogue and surveillance and external financial support in a balance of payments crisis. It may also include managing cooperative exchange rate arrangements for some members. A necessary precondition for effective crisis management is substantive and frank policy dialogue and surveillance; in this respect, the region should aim for policy interaction of the quality of Working Party 3 of the OECD.

The region is a major shareholder in the IMF and that institution remains essential to regional and global stability. If East Asia were to set up a regional fund, it would need to ensure that the objectives and operation of its two institutions were consistent (and the paper suggests practical ways to do this). As owners of both Funds, regional policymakers might choose to apply IMF conditionality in the regional fund. Or they might choose to manage localised balance of payments crises and apply conditionality independently, in which case they would need to ensure that regional mechanisms to identify and enforce conditionality were in place. Whatever the case, smooth crisis management would require close coordination and consultation between the two institutions.

A regional institution could be organised in a number of different ways. It could be an independent bureaucracy with a resident governing board. Or it could be a secretariat which provides expert advice on an independent basis with the final judgment made by finance ministry deputies acting under direction from their ministers. The latter model is more likely to fit with the preferences of regional policymakers for quick decision-making, minimal bureaucracy, and political control. But securing credibility and making these decisions enforceable would require that finance deputies be advised by an independent and highly reputable body within the institution. The reputation of a regional institution depends not just on getting the substance of its responsibilities and organisational structure right, but also on the perceived quality, expertise and independence of its staff and management.

This paper has argued that the route that East Asia — and perhaps Asia more generally — takes in developing a regional financial architecture depends on how it is engaged with, and involved in, the debate about the global financial architecture. East Asia participates in a range of international policy forums and is itself a major shareholder in the IMF. It is incumbent on the region to actively exercise its ownership responsibilities in these forums and institutions. But it is also necessary for other regions, especially North America and Europe, to engage constructively with East Asia as a partner in debates about reform. And it is also necessary for the IMF to engage more directly with the region. The more exclusive other regions are, the less likely is East Asia to see itself as a stakeholder in the global architecture and the more insular is the route that it may be inclined to take.

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