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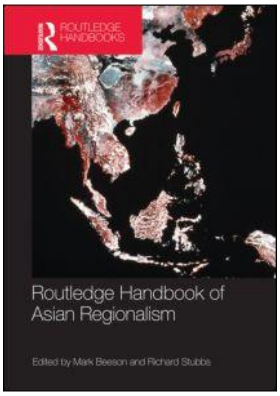

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10

Regional financial cooperation

Saori N. Katada

Introduction

In a region often characterized as full of nationalistic rivalries and averse to institutional commitment, integration optimists argue that East Asia's regional financial cooperation provides a shining beacon of hope. In the context of ASEAN Plus Three since 1997, the countries have not only established a formal arrangement in the region to provide emergency liquidity to countries in financial distress, but they have also proceeded to nurture the region's bond market and even discussed regional currency arrangements. Furthermore, these financial cooperation efforts have developed largely excluding the United States, and have had slow but sure impact on the global financial governance. Pessimists would disagree and point to the continuing reliance on IMF emergency funding, the region's heavy reliance on the US dollar, and the difficulty for the region to agree on an appropriate financial surveillance mechanism. Hence, this implicitly splits the literature on East Asia's financial cooperation into two normative camps. Moreover, scholars are analyzing a moving target as regional and global financial governance becomes defined and redefined during the last two decades, affected by the two major financial crises. In short, the task of understanding the nature of regional financial cooperation is quite complex.

Nonetheless, this chapter examines East Asian financial cooperation in the following steps. The first section summarizes the nascent efforts in the region against the backdrop of expanding regional economic networks in the late 1980s and the 1990s. The second section examines the way in which the Asian Financial Crisis (AFC) gave a visible rise to regional financial cooperation, and goes on to describe four important pillars of such cooperation: an emergency liquidity mechanism, regional bond initiatives, currency arrangement and a regional surveillance mechanism. The third and fourth sections each discuss important forces that have motivated regional efforts in this area. One is the challenge of managing financial cooperation in the context of regional power politics and global financial governance structures, and the other is the emerging identity of East Asia as a regional unit. Finally, the last section examines how to couch regional financial cooperation in larger pictures of regional economic integration, as well as the recent rethinking of the global financial architecture in the aftermath of the Global Financial Crisis (2008–9).

Pre-crisis financial cooperation in East Asia

In East Asia, where any region-wide cooperation efforts were previously limited (Wang 2004), the AFC of 1997–8 marked a watershed. Prior to the AFC, very few and only nascent financial

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cooperation efforts existed, many of which were initiated by Japan (Hayashi 2006, Chapter 2). A visible exception is the Asian Development Bank (ADB), a regional development financial institution, which has supported economic development of a broader Asia since 1966 (Yasutomo 1983; Wan 1995–6). On the monetary side, the power of the Japanese yen, thanks to its appreciation against the US dollar after the 1985 Plaza Accord, along with a rapid increase in Japanese direct investment in Southeast Asia, triggered concerns over the possible formation of a regional yen bloc (Dornbusch 1989). Such concerns heightened, despite fairly weak statistical evidence (Frankel 1993) and clear lack of willingness on the part of the Japanese financial authorities to promote internationalization of the yen.

By the early 1990s, the regional networks among businesses expanded throughout Southeast Asia (Hatch and Yamamura 1996; Katzenstein and Shiraishi 1997; Peng 2002) enhancing informal regional economic integration or regionalization (Katzenstein 2000). This was also a time when financial globalization reached the Asian shore with abundant foreign capital inflows, putting pressure on the governments to liberalize capital accounts (Cohen 1996; Kohsaka 2004). Globalized financial pressures had already caused severe balance-of-payments crises among emerging market economies, such as those in Latin America in the 1980s, causing the lost decade in the hemisphere. Crucial to the stability of the increasingly integrated region was to control massive inflow of foreign capital, but it was made difficult by premature financial liberalization promoted by globalization pressures (Helleiner 2000; Hamilton-Hart 2003a). Despite occasional discussion that the regional framework would be useful to secure financial stability, formal financial cooperation was slow to develop. With the aim of strengthening economic surveillance, the central bankers in the region established Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) in 1991 (Hamanaka 2009)[1] but the institution has limited influence on regional cooperation due to the secrecy of the meetings and lack of institutional commitment to coordinate supervisory influence (Yokoi-Arai 2006: 55). Other formal set-ups such as ASEAN or APEC Finance Ministers' Meetings (both since 1994) were formed in the context of broader regional diplomatic efforts.

Asian financial crisis and the rise of financial regionalism in East Asia

The AFC, which broke out in July 1997 as Thailand floated its baht after experiencing massive currency attacks, devastated the region's economies with the collapse of foreign exchange rates, massive exit of foreign capital, credit crunch and severe recession. Although with hindsight it is clear that the recovery was quite swift and robust, the shock of the crisis was profound for the region. In many ways, this shock gave rise to immediate and unequivocal commitment to regional financial and monetary cooperation.

The AFC shocks manifested in several forms, but all underscore the sense in East Asia of vulnerability and injustice in the way global financial governance occurs. Obviously, the first shock was the rapid deterioration of the regional economies as they experienced financial reversal (Goldstein 1998), and regional financial contagion – be it through financial channels (Kaminsky and Reinhart 2000; van Rijckeghem and Weder 2001) or through the dynamics of trade and competitive devaluation (Glick and Rose 1999). The region's analysts also emphasized the distinct nature of the AFC as the 'capital account crisis' in contrast to conventional current account crisis (Yoshitomi and Ohno 1999).[2] For smaller economies such as Thailand, the premature financial liberalization that invited massive movement of cross-border capital was deemed as the source of the problem (Kaminsky and Reinhart 1999). Meanwhile, the concerns regarding the vulnerability of the region's general dependence on foreign capital have led to the so-called 'double mismatch'

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discussion of debt denomination currency and the length of loan maturity. The mismatch of dollar dependence discussed below, as well as the overdependence of bank financing (Wade and Veneroso 1998) and underdevelopment of local bond market (McCauley 2003), led to rethinking of domestic and regional financial architecture. Additionally, the region's leaders felt strongly about the need to insulate regional economies from global forces through financial cooperation and regional currency arrangement (Helleiner 2000; Grimes 2003).

The second shock came through the strong ideological undertone of the debates regarding the causes of and appropriate prescriptions for the AFC, as the interests of mobile financial assets and Washington Consensus values are heavily represented in the IMF-led solution to the crisis (Jomo 2001; Beeson 2003). Granted that the IMF came under critical fire for its misguided prescriptions to those crisis-ridden Asian countries, but the countries that endured the IMF austerity measures, including Thailand, Indonesia and South Korea, found it convenient to blame the IMF for their economic hardship – a practice described as the 'politics of resentment' (Higgott 1998).

Finally, East Asia was shocked to find how little regional recourse it had at the time of the financial crisis. ASEAN was not strong enough, APEC was too diverse to generate solutions to the crisis (Webber 2001), and the ADB responded only timidly and inconsistently to serve as the regional lender of last resort (Wsley 1999). The international financial institutions, prominently the IMF, therefore, played the central role. Consequently, with the concerns of the detrimental impacts of the IMF prescriptions on the fragile economies of the region, a new regional framework of ASEAN Plus Three quickly occupied the centre stage of regional financial cooperation in the immediate aftermath of the AFC (Stubbs 2002). The ASEAN Plus Three, which included the three economically powerful Northeast Asian countries (China, Japan and South Korea), is a reincarnation of the East Asian Economic Caucus (EAEC) proposed by then Malaysian Prime Minister Mahathir in response to the rise of APEC in the early 1990s. The EAEC idea did not fly due to the vehement opposition by the United States against its exclusion and reluctance on the part of several Asian members (Leong 2001), but in the aftermath of the AFC, the ASEAN Plus Three framework has persisted.

Set broadly in the institutional context of ASEAN Plus Three, East Asia embarked on institutionalizing regional financial cooperation from the late 1990s with four related but distinguishable forms of cooperation: the Chiang Mai Initiative (CMI) of emergency liquidity mechanism against balance of payments crises, the regional bond initiatives, a regional currency arrangement, and a regional financial monitoring and surveillance function. Arguably, the CMI, established during the 2000 ASEAN Plus Three meeting in Thailand, is the most advanced and institutionalized of all (Henning 2002; Grimes 2009, Chapter 3; Rajan 2008). Until March 2010, this emergency liquidity mechanism was a compilation of bilateral currency swap arrangements between ASEAN members and the monetary authorities of the ' Plus Three' nations, which with their large current account surpluses and foreign exchange reserves are in position to provide emergency funding in dollars.[3] In addition, ASEAN members have had their own regional swap arrangements (ASA) of US$2 billion. The Asian policymakers, particularly those from Japan who originally proposed the Asian Monetary Fund (AMF), have long strived to pool the CMI swap lines to create a multilateral emergency funding institution in the region (Kuroda and Kawai 2004; Henning 2009). After the 2007 official agreement at the Kyoto meeting, the pooled Chiang Mai Initiative Multilateralization (CMIM) was finally established in 2010 with the total of US$120 billion in available funding.[4] Despite the progress of the last ten years, however, there are critiques of and sceptics about this mechanism (Henning 2002, Chapter 4; Eichengreen 2004). Most notably, from the set-up, the CMI has a so-called IMF-link as condition for its swap activation where only 20 per cent (increased from 10 per cent in 2005) of CMI swap resources can be activated without the crisis country's agreement with the IMF. This link does not only

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demonstrate the nested nature of the CMI within the global financial regime that uses the IMF to avoid moral hazard and to borrow credibility (Grimes 2006). Due to ruminants of IMF aversion, the IMF-link has made the CMI swap unusable in the eyes of the Asian borrowers. Such concern was heightened when, at the time of the 2008 global financial crisis, both the Korean and Singaporean governments resorted to currency swaps with the US Federal Reserve instead of turning to the CMI.

The AFC also highlighted the weakness of the region's financial market, which had heavily relied on bank lending (Goldstein 1998; Wade 1998a). The need for increased facility in direct financing in the Asian economies led to the pursuit of both domestic and regional bond market development (Rajan 2008; Grimes 2009, Chapter 5). The Asian Bond Fund (ABF) and Asian Bond Market Initiative (ABMI) were proposed in the early 2000s addressing respectively the funding and issuing sides of the bond market development (Amyx 2004). On the funding side, two relatively small funds (ABF-1 and ABF-2) were launched through the EMEAP members' investment in order to help fund regional bond markets in 2003 and 2005 respectively (Jung 2010). On the issuing side, ABMI launched several working groups in the ASEAN Plus Three context to foster capacity and infrastructure (credit guarantee, credit rating and settlement system etc.) to facilitate development of the regional bond market. Although the direct impact of those efforts are debatable, it is clear that the local-currency bond markets in emerging East Asia (excluding Japan) has rapidly expanded from US$537 billion in 1996 to US$4.4 trillion by the end of 2009, according to the Asian Bonds Online (Asian Development Bank 2010b).

The regional currency arrangement is the third and arguably the most important component of regional financial cooperation in East Asia that could have the most lasting long-term effects (Grimes 2009, Chapter 4). There is an abundance of discussion regarding the desirability of regional currency arrangement (Williamson 1999; Kwan 2001) and the surprisingly high levels of progress towards Optimum Currency Area conditions that East Asia has already achieved (Eichengreen and Bayoumi 1998; Watanabe and Ogura 2006). Nonetheless, there has been no actual progress in shaping regional currency arrangement. After the first step in the form of post-AFC Japanese initiative to increase the use of the yen in the region did not bear fruit (Grimes 2003), the push for common currency unit – Asian currency unit (ACU) – emerged from the ADB in 2005 and the issue was passed on to the ASEAN Plus Three forum to be discussed further. As discussed below, the dollar standard in East Asia is both economically and politically entrenched, and many are sceptical about the feasibility of regional currency (Eichengreen 2007, for example).

Be it the activation of emergency liquidity funding or the establishment of regional currency unit, the monitoring and surveillance of the region's financial stability and macroeconomic prudence is critical. The last component of regional financial cooperation addresses that challenge of regional financial and monetary surveillance. The establishment of Economic Review and Policy Dialogue (ERPD) within ASEAN Plus Three since 2000 has sought to provide such a regional mechanism, but the process thus far remains a semi-annual discussion over country-specific macroeconomic data, and not any surveillance (Grimes 2009: 87–88). The new CMIM with its headquarters in Singapore is set to install a much more independent and rigorous surveillance mechanism than the ERPD through ASEAN Plus Three Macroeconomic Research Office (AMRO). The jury is still out, however, on the effectiveness of the new mechanism.

The last ten years has seen institutional innovations in the region with the aim to enhance cooperation. Scholars point out, however, that such arrangements meet various domestic challenges. First, some ASEAN governments, in their financial regulatory capacity, fail to participate in regional financial cooperation effectively (Hamilton-Hart 2003b). Second, the variation in

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member countries' financial systems feature of balance-of-payments positions has thus far led to eclectic preferences towards regional financial cooperation (Hiwatari 2003). Finally, even though many East Asian countries that underwent the crisis have gone through fundamental financial reforms, the compliance with the prudential regulatory standards in the emerging East Asia has been uneven (Walter 2008). The assessment of effectiveness and progress of these efforts thus far is divided. The regional financial cooperation has, nonetheless, become a staple in East Asian economic governance discussion.

Regional financial architecture in global context

The rise of interest in East Asian financial cooperation has its roots in the way the region is embedded in the global economic and financial structure, and how its governance influences the region. Notwithstanding domestic difficulties, as discussed above, or the often cited rivalry between China and Japan, discussed below, the attraction of regional financial and monetary arrangements endures as a way to enhance power, secure the regional financial stability and increase the voice of East Asia in global governance.

The first strand of work done to explain the slow but sure rise of regional financial cooperation examines major power politics. One of the most frequently cited challenges against smooth regional financial cooperation in East Asia in recent years is the rivalry and tension between two major powers in Asia: China and Japan (Dieter 2008). Some also note that the shortage of combined leadership between Japan and China constitutes a major weakness of East Asian regionalism (Kwack 2004). Not only has the historical legacy of Japan's failed attempt to establish its empire in the 1940s cast a dark shadow over Japan's efforts to take the leading role, but the rise of China and its increased interests in engaging the region as a benevolent leader (Shambaugh 2004) also makes regional cooperation in many issue areas complex. In terms of leadership competition in the region, the AFC once again was a watershed. Despite intense interest on the part of the Japanese financial authority to engage actively in containing the regional financial crisis in the autumn of 1997, the country's domestic financial implosion prevented the Japanese government from moving aggressively (Amyx 2000). Meanwhile, the Chinese authorities, which at the time were shifting their strategic thinking and foreign policy stance to increase the prospect of China's peaceful rise (Deng and Moore 2004), managed to gain high marks for resisting the pressure to devalue its currency and compete against the Southeast Asian strategies of 'exporting their way out of crisis' with their own massively devalued currencies (de Santis 2005). After the immediate crisis passed, the Chinese support of the CMI, unlike its opposition to the AMF, allowed regional financial cooperation to flourish (Chey 2009).[5]

The role of the United States is another important feature of power dynamics in East Asian regionalism, as Asian players try to either exclude or minimize the American influence in pursuit of a higher level of regional autonomy (Bowles 2002). The US initially mishandled the Thai crisis by not contributing any financial help. Furthermore, the apparent American support of a neo-liberal approach to financial liberalization in the region, that preceded the crisis, as well as to the stringent (and inappropriate) IMF conditionality in the aftermath of the crisis, heightened the aversion to the US involvement in regional financial matters. As the US, China and Japan have distinct interests in the regional financial configuration and priorities in regional financial cooperation (Grimes 2009), major power politics tend to produce uneven development depending on the aspects of the regional financial architecture.[6]

The tension between the region's financial policy priorities and the politics of international financial architecture constitutes a second explanation about how interests in regional cooperation have persisted. The AFC kicked off another round of policy debate regarding international financial

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architecture (Eichengreen 1999) and the role of the IMF and the World Bank in financial crises.[7] Within East Asia, the shock of IMF austerity measures imposed on the crisis-ridden countries triggered vocal criticism against the IMF, the institution that lacks political legitimacy in East Asia particularly because the region's voices are (considered) to be inadequately represented in the institution (Sohn 2005). One of the main purposes of regional financial cooperation excluding the United States is, therefore, so that East Asia can work as a collective group and enhance the region's bargaining power to counterweight the influence of the US and the IMF (Katada 2004).

East Asia is highly dependent on global economy, including its prominent dependence on the US dollar, one of the two sources of double mismatch. Much of the foreign economic transactions in East Asia go through the US dollar, and there was no regional coordination of the foreign exchange regimes (Cohen 2008). In order to buffer the economies from the uncertainty and to maintain a competitive foreign exchange rate in the global market, China and Japan have accumulated the total of US$3.7 trillion in dollar-denominated foreign exchange reserves as of September 2010, thus creating a strong symbiotic relationship with the currency. This obviously makes it difficult for the region to turn against the dollar and towards a regional currency arrangement. For some countries, such as Japan, high dependence on the US dollar is evidence of US structural power (Katada 2008), while for others, such as China, high export dependence and pursuit of macroeconomic policy autonomy makes the government prefer the use of the US dollar (Bowles and Wang 2008).

Influential economists argue that underdeveloped financial markets in East Asia perpetuate the region's US dollar standard, as governments seek to stabilize the countries' external balance (McKinnon and Schnabl 2004). Dooley *et al* (2003) argue that current global monetary structure (so-called 'Revived Bretton Woods') is likely to continue because East Asian countries opt in favour of accumulating large US dollar reserves, even at high and increasing cost (e.g. foregone returns on these investments and capital losses resulting from US dollar depreciation). This is due to the much higher political priority that those countries place on compiling an internationally competitive capital stock to expand industrial production and absorb excess labour. These regional interests are complementary to those of the US, according to this perspective, which can live beyond its means by incurring substantive current account deficit financed by Asian reserves. In sum, such global financial complementarities do not help East Asia in establishing a regional solution, especially when it comes to currency issues.

Finally, diffusion through emulation and learning plays a role in East Asia's interest in financial arrangements, particularly in its relations with Europe. Despite widespread scepticism over the possibility of replicating the European historical experience in East Asia or the region's particular culture (Angresano 2004; Baldwin 2008a), the euro, newly born in 1999 on the heels of the AFC, became East Asia's inspiration and model to emulate as the countries struggle to find an alternative to their US dollar dependence. Even prior to the AFC, East Asia began in 1996 to interact with Europe as a region through the Asia-Europe Meeting (ASEM), which became the first official arrangement that excludes the United States (Bobrow 1999). It is in the context of the ASEM where one of the first studies of East Asian regional currency was conducted, as they formed a research group deriving lessons from European experience (Nicolas 2008).

Ideas, identity and learning to cooperate

The rise of interest in regional financial cooperation in East Asia is closely associated with the emergence of regional identity and development of a policy network in the area of finance after both Southeast and Northeast Asia experienced the AFC. Along with the economic devastation, the AFC had (at least temporarily) dethroned the East Asian economic model (Wade 1998b),

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which only a few years prior was hailed as the secret of the miraculous economic growth in Asia (World Bank 1993). As the crisis put these economies into a tailspin, there was a massive 'discursive' attack by the 'Washington Consensus' establishment against the way the region's economy was managed (Hall 2003). The very nature of the IMF solution to the crisis-ridden countries firmly confirmed the neo-liberal bias. The government's role in the economy (despite a relatively balanced central budget) was drastically reduced, leading to misery and hardship among the people of the countries that lacked a social safety net (Haggard 2000).[8]

In this context, the first sign of regional solution to the crisis came from Japan, as its finance minister proposed the AMF in September 1997. The idea of a regional rescue fund was fundamentally embedded in Japan's developmental thinking (Lee 2006), based on which Japan engaged from the late 1980s in challenging the Washington Consensus (Lee 2008). Protection of the developmental state model, according to some Asian observers, has become one of the important objectives of 'insulation' that the regional financial cooperation would provide (Bowles 2000; Hatch 2002). The premature proposal was, however, shot down quickly by the US and others, as it invoked concerns over moral hazard and its challenge to the IMF authority.

Such challenge resonated in East Asia as the AFC provided a common sense of history for East Asians, their leaders and policymakers (Stubbs 2002). The shock wave from the AFC went beyond economics, and has provided the basis for a common identity that constitutes the social basis for the ASEAN Plus Three (Terada 2003). The humiliation of having national sovereignty compromised also struck a sensitive chord among Asians, as they saw the picture of Suharto, the former President of Indonesia, signing a (degrading) IMF agreement with Michel Camdessus, the managing director of the IMF, who was standing tall with arms crossed seemingly looking down at Suharto. This image acted as a haunting reminder reminiscent of the colonial era (Budianta 2000).

Finally, the expanding networks among Asian financial and monetary policymakers, and socialization that takes place within the community, holds the key to the current and future course of East Asian regional financial cooperation. The AFC installed the regional efforts to create the policy networks that allow contacts and communications to flow freely in East Asia, and which have changed the course of financial institutional development in the region (Calder and Ye 2004). Through these networks, and with the active discussions in the region, social learning has become the centrepiece in diffusing the value of financial cooperation among experts and policymakers, particularly in China (Sohn 2008).

Regional economic integration, global financial crisis and the way(s) forward

Where is financial cooperation in East Asia going from here? One way to address this question is to place the last ten years of financial cooperation efforts in two distinct contexts. One is how cooperation related to the region's overall economic integration and region-wide security-building efforts; the other is to examine how cooperation efforts have been affected by the Global Financial Crisis of 2008–9.

The mushrooming of free trade agreements that crisscross the Pacific are another feature of regional economic integration surrounding post-AFC East Asia (Katada and Solís 2008). This chapter leaves the analysis of the motivation behind regional trade cooperation to others (see Dieter, Chapter 9 of this volume), and will only discuss those developments in relation to regional financial cooperation. In terms of sequencing, East Asia exhibits simultaneous regional integration efforts, in contrast to the step-by-step European experience and the 'logical roadmap' posed by Balassa (1961b). This raises the possibility of a unique path towards regional integration, where the sequence starts with financial cooperation (Dieter and Higgott 2003). Nonetheless, uneven development and eclectic membership prominent in the two issue areas suggest lost efficiency from regional economic integration. For example, proponents of a positive impact of the common currency on increased trade (Rose and Stanley 2005) have little to say at this stage on the prospects of deepening East Asian economic integration. This is because the prospects for a common regional currency are still quite remote (Pomfret 2005). More optimistically, we might be able to derive some security benefits from regional financial cooperation, which has fostered regularized meetings and relatively clear membership in the region. Those regular interactions in the area of non-security issues, nevertheless, increase the opportunity costs of disruption, such as war, and allow frequent information exchange (Bearce 2003) and socialization (Cohen n.d.).

The Global Financial Crisis, triggered by the collapse of Lehman Brothers in September 2008, turned a new page in East Asian financial cooperation (Beeson 2011; Grimes 2010). On the one hand, a year prior to the onset of the immense crisis, some economists in the region found comfort in the discussion of 'decoupling' East Asian economies from that of the US economy (and to some extent that of Europe), which was rattled by the subprime mortgage crisis since 2007 (Kawai and Motonishi 2005; Mahbubani 2008). On the other hand, many economists began to argue that the continued export success and abundant savings among the East Asian countries, the so-called 'savings glut', had contributed to the global imbalance (Bernanke 2005).

The Global Financial Crisis, however, did not spare East Asia, at least in the immediate aftermath of the Lehman shock. Curiously, though, and due to relatively careful and timid liberalization of the financial sector in East Asia, the immense crisis wave reached the Western Pacific shore mostly through trade channels rather than financial ones (Goldstein and Xie 2009). As the demand for finished goods from Asia came to a screeching halt, the dramatic collapse of trade in the region affected all the exporting East Asian countries alike. The issue of rebalancing and shifting the basis of development from external to internal demand (Asian Development Bank 2009), and the strengthening and multilateralization of the CMIM, were seen as urgent in order to place another layer of financial safety across East Asia.

The Global Financial Crisis has had a systemic impact on global financial governance and, thus, regional financial cooperation in East Asia. On the one hand, the crisis shifted the centre of financial governance discussion among the financial ministers and the heads of state from the old G7 to the G20, a forum established in 1999 that includes important Asian members such as China, India, Indonesia and South Korea as well as the long-time G7 member Japan. Within this context, the G20 and the reform of the IMF – with emphasis on more prominent representation of emerging market economies, particularly those in East Asia – is seriously discussed. In addition, each East Asian government has engaged in domestic stimulus to obtain relatively fast economic recovery. All these trends have led to weaker, not stronger, emphasis on regional financial cooperation (Emmers and Ravenhill 2010) as the need for a coherent regional voice has diminished.

In this crisis, intense uncertainty associated with the global economy and the status of the US dollar as the key currency, accompanied by 'financial deglobalization' (Eichengreen 2009), led the East Asian financial authorities to consider seriously shifting their currency dependence away from the US dollar. At the height of the crisis, the Chinese government, with its interests in gradually internationalizing Chinese currency, began to demonstrate its changing calculation (Park 2010).[9] Concomitantly, the struggling European economies have cast doubt on the desirability of regional monetary arrangements – as the region's common currency, the euro, has become an obstacle to swift macroeconomic adjustment among many of the heavily indebted European governments. In sum, despite positive externalities that regional financial cooperation could produce for East Asia, the region's 'logical roadmap' has never been clearly laid out. Moreover, unlike the AFC, the 2008–9 Global Financial Crisis with its multitude of impacts did not reinforce the regional cooperation needs as strongly as regional integrationists have hoped.

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Conclusion

There are politically charged debates over the future of regional cooperation in East Asia, and financial cooperation is not an exception. This chapter has demonstrated that there has been visible progress in the development of a cooperation framework in the aftermath of the AFC as compared to the pre-crisis. The motivation of such cooperation, though, has more to do with the region's defence against a precarious global financial environment and its desire to project its voice in global financial governance than common aspiration towards coherent regional economic integration. The major powers involved – China, Japan and the United States – have distinctive interests in the way financial cooperation should proceed, and there is a structural barrier such as the region's high US dollar dependence that makes autonomous efforts difficult. The reaction to new economic challenges after the Global Financial Crisis has also been mixed, which raises the question regarding consistent regional commitments among Asian leaders.

Optimists might be right in pointing to the changed mindset among Asian leaders in looking at regional financial cooperation as a viable option to foster regional identity and to influence the regional and global financial governance debates. At the same time, pessimists and sceptics are correct in pointing out that no visible, costly commitment has yet been made on behalf of regional financial cooperation. With the challenges that Europeans are facing in maintaining the euro under the current crisis, East Asian governments are extremely cautious in advancing regional options at the cost of a global one. The future of East Asian economic cooperation, including that of financial cooperation, is clearly embedded in the global economic context.

Notes

1 The participating members of EMEAP are: Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, and Bank of Thailand.

2 A similar discussion on the cause of the AFC proceeded among the economists in the United States. The controversy is best summarized with Radelet and Sachs (1998) emphasizing the panic-stricken behaviour of domestic and international investors and the failure of the IMF response on the one hand, and Roubini emphasizing the economic distortions among the countries in Asia and the problems of fundamentals (Corsettti, Pesenti and Roubini 1999) on the other.

3 Exceptions are the swap lines among the Plus Three countries, which are denominated in yen, RMB and won.

4 The voting power of the member nations are distributed in the following manner: China with Hong Kong (32 per cent), Japan (32 per cent), Korea (18 per cent).

5 The original AMF proposal by Japan's Ministry of Finance was put together hastily in the summer of 1997 as the region faced the massive financial crisis. It is noted that the Japanese government first went to the Hong Kong monetary authority, not the People's Bank of China, to discuss the AMF idea, a move that was considered a 'non-starter' by the Chinese leadership (Amyx 2005).

6 Grimes (2009, 30) summarizes the contrasting preferences among the three major powers where (a) the US and Japan prefer financial liberalization and rule-based financial market development; (b) China and Japan will engage to insulate the regional economies from global volatility influenced by unilateral US macroeconomic policies; and (c) Japan has a harder time moving away from the US dollar standard than China.

7 The so-called Meltzer Commission (International Financial Institutions Advisory Commission) was established by the US Congress in 1998, and it published a report in March 2000 outlining the problems of the international financial institutions and their report agendas.

8 The economic downturn at the time of the Asian Financial Crisis in Korea was widely remembered as the 'IMF crisis.'

9 Zhou Xiochuan (2009), the governor of the People's Bank of China, for example, surprised the world by publicly discussing the need for creating a neutral currency, such as the Special Drawing Rights (SDRs), to sustain the liquidity needed for global economic transactions. For more discussion, see Chin and Wang (2010).