

Regional Financial Cooperation in East Asia from a New Perspective

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I. Introduction

Following the Asian financial crisis of 1998, there was a need to improve regional financial cooperation, including liquidity support. As a result, the Chiang Mai Initiative (CMI) was signed in 2000 at the ASEAN+3 Finance Ministers' Meeting, and institutional initiatives to deepen regional financial cooperation have been ongoing for the past two decades. The Chiang Mai Initiative Multilateralization (hereinafter, CMIM) and the Asian Bond Market Initiative (hereafter, ABMI) are two of the outcomes of this initiative.¹

However, it is difficult to find countries that are actively using these mechanisms. For example, despite the fact that the blockade caused by the spread of COVID-19 in 2020 resulted in a decline in economic activity and financial market instability, none of the ASEAN+3 countries attempted to resolve market instabili-

ty through regional financial cooperation mechanisms. Against this backdrop, we will first examine the limitations of existing systems and propose ways to overcome those limitations, as well as new ways to strengthen East Asian financial cooperation.

II. Overcoming the Limitations of CMIM and ABMI

1. CMIM

The poor performance of CMIM can be attributed to a number of factors. The stigma effect of being tied to the International Monetary Fund's (IMF) conditionality is an unavoidable factor. The quantity of relief is similarly limited, and the funding comes from pre-designated foreign exchange reserves held by each member country. Furthermore, even when the region's

¹ This article is based on the discussion in Yoon, D. R., S. An, H.-Y. Chai, Y. Rhee and W. Moon (2020) East Asian Regional Financial Cooperation: Visions and

Challenges, Policy Analyses 20-33, Korea Institute for International Economic Policy.

institutional weaknesses were identified, reform was difficult due to a lack of vision and leadership.

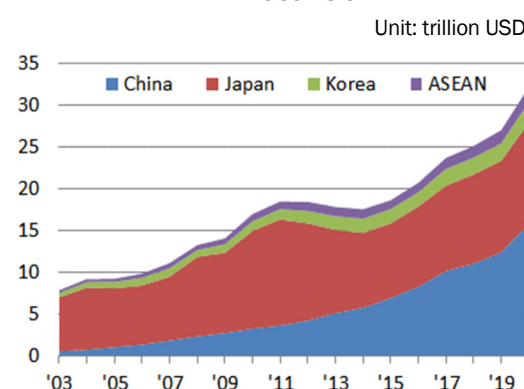
The following are some ideas for improving CMIM's effectiveness. First, we propose creating a "CMIM Fund" and implementing regional currency cooperation and regional settlement systems in conjunction with financial cooperation as the future vision of regional financial cooperation. Second, adding Australia and New Zealand as new members will be beneficial. This is in order to take advantage of those countries' sophisticated finance businesses while also overcoming the sluggish financial cooperation created by political disagreements among the former member states.

2. ABMI

Because ABMI has implemented the policy of releasing a new roadmap every certain period of time, it has been performed the most within the ASEAN+3 framework. As a result, ASEAN countries have made it easier to establish financial infrastructure and institutions, as well as expand the local currency denominated bond market (Figure 1). However, due to the disparity in economic development among member countries, there are limitations, such as the continued gap in bond market development across ASEAN+3 nations and the still significant regional infrastructure investment gap.

We propose an expansion of areas, including Australia and New Zealand, to solve these issues. This proposal can be viewed in the same light as the improvement of CMIM's governance structure with the participation of Australia and New Zealand. This can be understood as numerous occurrences of assets in currencies in these countries moving in the opposite direction to Japanese yen assets, and it can be observed that it helps in the construction of an optimal portfolio. As a result, efforts to broaden ABMI's regional reach, which includes Australia and New Zealand, will be significant.

Figure 1. Size of Local Currency Bond Market in East Asia



Notes: 1) Data for China includes that of Hong Kong.

2) ASEAN consists of Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

Source: Asian Bonds Online.

Next, we would like to suggest three ways to strengthen financial cooperation in East Asia from a new perspective, rather than solving the problems of the existing system.

III. Suggestions from a New Perspective

1. Monetary Cooperation through Central Bank Digital Currency

East Asian monetary cooperation has failed because it has set a low realistic goal of regional exchange rate stabilization. Accordingly, we would like to consider establishing a more specific goal of "cooperation in the issuance and widespread use of Central Bank Digital Currency (hereafter, CBDC)" and brainstorming ways to achieve more visible results.

If CBDC is introduced and used for international payment and settlement, the problems of the cross-border payment and settlement process, such as high costs, high risks, and uncertainty, can be solved by improving payment settlement efficiency and promoting the internationalization of the local currency.

Of course, there also exist disadvantages. Currency substitution can occur frequently when an East Asian CBDC block is formed due to the low cost of currency exchange, which can increase the volatility of money demand and make it difficult to establish monetary policy in each country. Currency substitution is more likely in countries with high inflation and low confidence in their currencies, which may lead to dollarization.

However, rather than reducing options due to excessive concern, we believe that the time has

come to focus on realizing the potential of cooperation through CBDC. More specifically, the ASEAN+3 Finance Ministers and Central Bank Governors Meeting or Regional Comprehensive Economic Partnership (RCEP) could consider adding "cooperation through CBDC" as a new agenda item.

2. Establishment of Development Financial Institution in Northeast Asia

As the "last major economic resort of the Asian continent," the North Asian region has tremendous growth potential and enormous demand for investment (Table 1). However, funds are insufficient to meet this requirement. In light of this, the establishment of a development financial institution in Northeast Asia, such as the Northeast Asia Development Corporation, is proposed. In other words, this would mean a transition to regional development cooperation and expanding and shifting its center to Northeast Asia in order to replace the existing cooperation structure centered on ASEAN+3.

Table 1. Estimation of Demand for Development Investment Fund in Northeast Asia

Unit: billion USD

Country	Total Infrastructure Investment	Facility Investment
Three northeastern provinces in China	25.6	10.4
Far East Russia	14.9	6.0
Mongolia	6.2	2.9
North Korea	16.2	9.8
Total	62.9	29.1

Source: Author's calculation.

The Northeast Asia Development Corporation appears to be the best option for the reasons listed below. First, it does not necessitate membership in international financial institutions when supporting funds first, allowing for efficient allocation of funds. Furthermore, development-related banks in each country can avoid the form of international organizations, and local governments can participate instead of central governments, making it simple to establish. There are numerous additional benefits, such as encouraging private participation and, from the standpoint of Korea, fostering the asset industry and enabling efficient use of long-term capital.

Considering regional politics, however, we must encourage local private financial institutions to participate by leading development-related banks, cooperating with existing multilateral development banks, and emphasizing commerciality. It is also necessary to refrain from having China play a key role, as this participation could devolve into an extension of its foreign strategies, rather than regional development and cooperation.

3. Financial Cooperation with Central Asia and Mongolia

Central Asia and Mongolia are regions which are relatively underdeveloped and in desperate need of development financing. Making Central Asia and Mongolia regional alternatives is important in light of Korea's ability to plan a response strategy to Japan, led by the Asian Development Bank, and China, led by the Asian

Infrastructure Investment Bank (AIIB).

The "Korea-Central Asian Financial Cooperation and Training Center (tentative)" will be established as soon as possible for Central Asia to maintain the momentum of financial cooperation and to broaden the scope of cooperation to macro-financial fields such as KRW settlement cooperation. This should be promoted in a direction that promotes cooperation in the real sector, such as long-term discovery of new growth engines for the Korean economy, and finally, we need to build a trilateral financial cooperation system between Korea, Europe, and Central Asia through cooperation with Europe, particularly the European Bank for Reconstruction and Development (EBRD).

Table 2. Direction of Financial Cooperation among Korea, Central Asia and Mongolia

	Stage 1	Stage 2	Stage 3
Theme	Research and Training	Macro-financial (Payment) Cooperation	Development Financial Cooperation
Operations	Establishment of Think Tank like South East Asian Central Banks (SEACEN)	Pilot Project to Internationalize Korean Won (via Won Swaps)	Link to ODA Projects and Entry of Private Financial Institutions
Leader	Bank of Korea	Bank of Korea & Government	Government & Bank of Korea

Source: Author.

IV. Conclusion

As previously discussed, we propose a new policy alternative to address the shortcomings of East Asian financial cooperation. Of course, more precise planning is required to implement these alternatives, and it is also recognized that the topics covered in this study represent only a subset of regional financial and monetary cooperation. However, by overcoming the limitations thus far, it is hoped that it can be a contribution that provides at least a glimmer of thought, which can hopefully become more concrete in future studies. **KIEP**