

Institutional Approach to the Needs and Possibilities of Financial Cooperation System in East Asia

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I. Introduction

Since the 1998 foreign exchange crisis, international cooperation among East Asian countries has been intensified, including currency swap deals under the Chiang Mai Initiative. It has been caused by the limitation of financial cooperation under the existing IMF system and the increase in foreign trade and capital market transactions in the East Asian region. Before the foreign exchange crisis, the financial cooperation of East Asian countries was centered on intensifying the relationship with the United States or European countries rather than the regional integration, and the IMF was at the center.¹ Under the system like this, however, the East Asian countries had limited success coping with the financial market instability caused by a temporary lack of liquidity or an increase of rapid capital movement, especially in financial sectors, despite the steadiness of fundamental economic structure. Accordingly, the East Asian countries began a discussion on construction of financial cooperation system in the region. Looking for concrete steps, they are making progress in establishment of Asian Monetary Fund(AMF), which is the financial cooperation system among nations in the region, as well as the currency swap, and furthermore the discussion on establishment of Asian common currency is in progress now.

As the major structure of this paper is to take a look at the current situation and issues of the existing international financial structure, in which the financial cooperation efforts of East Asian region are set, in particular, the issues of decision-making system and monetary policy operation will be looked into and the roles of G-20 and FSB, which has been in the spotlight recently in connection with the financial crisis, will be reviewed as well. And then, the discussion on the financial cooperation system carried out up to now will be arranged historically, in respect that the discussion on the financial cooperation system, which is becoming an issue currently, has been handed down from the past. Subsequently, the Chiang Mai Initiative, which is providing the detailed contents of financial cooperation system in East Asia, and the roles of ERPD (Economic Review and Policy Dialogue, ERPD), to foster as the Asian bond market, to function as macro economic policy guidelines and financial supervision will be examined. And based on the examination, a discussion will be carried out regarding possibility of AMF establishment and cooperation with the existing international financial institutions. In addition, the possibility of acceleration in financial cooperation through FTA in the region and establishment of Asian common currency system will be studied.

II. Overview of the current international finance system

Today, in case of crisis caused by the freedom of capital movement and shortening of investment period, the international finance market does not react to the crisis on a regional basis, and it shows a rapid diffusion due to mutual investments and contagion effects.

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¹ Bokhyun Cho, 'Financial Globalization and Financial Cooperation in East Asia', 12(1) *Research for Economic Development*(2006), at 124.

However, the countermeasures at the level of international finance organization to cope with the crisis appear to be very limited in terms of quickness and effectiveness, so researchers are suggesting that the structure of international finance shall be reorganized in order to deal with the problem, providing the motives for intensification of regional financial cooperation simultaneously.

A. Decision-making structure of the IMF and critical review on policy operations

1. Critical review on decision-making structure

As for the decision-making structure, they raise the issue that basically there is a wide gap between the decision-making structure and the economic strength of member nations. Despite the continuous increase of quota-based voting right, in which a single vote is allotted per one hundred thousand SDR, it is indicated that the balance of voting rights between advanced and developing countries has been upset as the 250 basic voting rights symbolizing the right to equality among member nations have not changed. And also, it is viewed as a problem that the quota, which decides on a voting right, is not in proportion to the GDP of relevant country in the case of quotas.² The reason the weighted voting system has been incorporated into Article 12 Clause 5, item (a) of IMF Agreement has originated from a rational consideration that the decision-making on matters about international monetary finance, where the actual economic strength has been reflected, does not correspond to the reality. Today, on the contrary, such a quota system is facing the criticism that it is not able to reflect the actual economic strength of developing countries.³ Besides, on the other hand, as the actual flexibility of quota, namely the change of quotas, requires the consent of over 85 percent of total votes, it appears that the quota change will be difficult in reality when the United States and Europe are against the change, in consideration of the relative importance of them. Reflecting such a situation, the share of Korea, Turkey, Mexico and China were increased at the September 2006 annual meeting of the IMF.⁴

2. Supplying funds and critical review on Conditionality

As for the conditions for receiving IMF funds, lots of criticism has been raised by the nations that received the fund. Especially, in case of a temporary international payments imbalance amid liberalization of exchange, exchange rate devaluation, higher interest and financial deficit management and facilitating foreign investment, various questions are raised regarding whether the policies like liberalization of foreign exchange, high interest policy and liberalization of foreign investment are compulsory conditions.

The term, 'conditionality', we often use, is a condition that is annexed in order to carry out the economic stabilization program of the IMF.⁵ In the case of a country which is trying to borrow funds in excess of the reserve tranche, the 25% of its quota, in other words, the

² Sohn, Injoo, 'East Asia's Counterweight Strategy: Asian Financial Cooperation and Evolving International Monetary Order', (2) *G-24 Discussion Paper Series*, (March 2007), at 2; Catherine H. Lee, 'To thin own self be true : IMF conditionality and erosion of economic sovereignty in the Asian financial crisis', *University of Pennsylvania Journal of International Economic Law*, (Winter 2003), at 902.

³ As of 1998 when the foreign exchange crisis broke out, Korea, Brazil Belgium and Netherlands were retaining 16.34 billion SDR, 30.36 billion SDR, 46.07 billion SDR, 51.62 billion SDR, respectively, according to KIEP; Reevaluation of IMF governance; *World Economy* (March 2002), at 91.

⁴ The stakes of Korea, Turkey, Mexico and China increased by 76%, 22%, 18%, and 25% respectively. And as of July, 2006, the votes of the United States, Japan, China and Korea out of total are 16.79%, 6.02%, 3.66%, 1.33% respectively.

<http://www.imf.org/exteranl/np/memdir/members.htm#3> (visited 15 June, 2009) .

⁵ See Article 3 of Agreement of the IMF, and see also Guideline on Conditionality Decision, 2864 (02/102)

country tries to use the fund using the 100% of credit tranche, it shall comply with the economic stabilization program of the IMF when it receives the fund. The mechanism of such programs is what is called a Stand-by Agreement, and the country borrowing a fund shall implement the requested terms of monetary and financial operation, including restructuring, complying with the agreement. The circumstance where such an economic stabilization program is added to the fund support service has been caused by the suspicion if the balance-of-payment problem of the applicant in 1952 was a temporal situation and the policies promoted by the relevant country were able to get over the then situation.⁶

In the time of foreign exchange crisis, however, from the standpoint of Korea, the positive sides may be acknowledged as the economy of the country recovered in a relatively short time through the support from the IMF, and the imaginary quantities unnecessary for the economy were eliminated in many sectors. But on the contrary, the social problems such as the dismantled society, collapse of industrial foundation, and polarization, caused by the secondary effect that had kept going for 8 years even after the completion of fund support.⁷

Especially, the fact that the same conditionality was annexed though the foreign exchange crisis of Korea was different from that of Latin America in the 1980s has suggested a question whether the relevant measures were appropriate.⁸ In connection with this question, as the IMF was making a guideline of financial support it made an effort to include the matters, such as securing the voluntary actions of supported countries, simplifying the support conditions and considering the basic economic condition of supported countries, but there still seems to be no big difference in carrying out a restructuring in a large scale.⁹

After all, coming up with the subject that transparency and liability shall be raised in the imposition of conditionality along with the improvement of transparency in the governance structure of the IMF, it became the powerful motive as to the necessity of establishing a monetary fund in a new style in the region.

B. Intensifying the roles of G20 and the limit and future

During the progress of the recent financial crisis started by America, the best helper, which eased the anxiety in the international finance market and restored the normal function in the financial market, was the G-20, not the IMF. The G-20 was launched in November, 2008 based on the proposal of Sarkozy, the French President, in August of the year, and the purpose of the conference was to look for international mutual assistance to prevent the international expansion of the financial crisis started by America and discuss how to set up a new international finance and monetary order (Bretton Woods II). Especially, in the London Summit held in order to overcome the international finance crisis in mutual cooperation, some impetuous prospects, where the G-20 might replace the function of the IMF due to the financial efforts of the participants to restore the macro-economy, the reformation problems of the IMF and boycott or adoption of financial protectionism, were proposed. Any way, it is considered as an eye-opening progress that as a concrete execution plan, the G-20 has

⁶ Sidney Dell, *'On Being Grandmotherly: The Evolution of IMF Conditionality'*, Princeton, N.J.: Princeton Univ., (1981), at 11; Kim Wangsik, 'The Effect of IMF Programs in Economic Stabilization', 25 (1) *Journal of the Korean Political Science Association* (1991), at 501.

⁷ As for the policies carried out by the IMF at the time, there are many suggestions that the then high interest policy of the IMF was in the wrong direction, compared to Malaysia that made a success in economic recovery without financial support of the IMF. And in reality, there are many criticisms on the fact that such a policy has not been advised for the financial crisis started by America.

⁸ Stiglitz, Joseph, *'Die Schatten der Globalisierung'*, Siedler, Berlin, (2002), at 125-152; Catherine H. Lee, above n2, at 888-901.

⁹ Daeki Lee, 'Improvement plan for the problems in the Loan System of the IMF'. 18(3) *Weekly Financial Brief*, Korea Institute of Finance, at 11.

presented the action plan that includes intensification of mutual cooperation in macro-economy policies, intensification of financial supervisory function centered on Financial Stabilization Board, intensification of risk control over hedge funds and sharing tax avoidance information.¹⁰

¹⁰ See the Progress Report on the Action of the Washington Action Plan presented by the G-20 in order to look for the 47 items of Action Plan and the progress and next steps of the plan.

Main points related to the financial cooperation in G-20 London Summit

Detailed fields	Main points
Intensification of mutual assistance in macro-economy	<ul style="list-style-type: none"> - Agreement on expansion of financial expenditure and extensional monetary policy - Expansion of loan support for new developing countries and poor countries - Declaration of avoidance of policies related to financial protectionism
Reform of international financial organization	<ul style="list-style-type: none"> - Establishment of financial stabilization committee - Making efforts to improve the IMF quota and voting system - Making efforts to implement the innovation plan for World Bank - Securing financial resources and expansion of access limit related to intensification of support for developing countries and rising countries.
Intensification/improvement of financial supervisory and regulations	<ul style="list-style-type: none"> - Checking the recommendations of the G-20 according to the FSB and IMF - Expanding the number of countries participating in the BCBS - Intensification of hedge fund risk control through registration and publicized information - Execution of periodical supervision on credit assessment firms - Intensification of supervision on risk taking of financial institutions' employees and compensation system. - Readjustment of accounting standards for financial instruments - Operation of the FSAP to raise the level of transparency in financial regulation system.

* Arrangement of the material from the web site, [www. G-20. org](http://www.G-20.org).

But the most vulnerable point of the G-20 is the fact that it has not conformed to the forms of traditional international organizations, so there is a limitation that it can not maintain continuous activities and has no consistent norms with legal binding power in connection with the decision-making process. Besides, the fact that the G-20 has a relatively wide range of subjects for discussion is hindering the meeting from playing core roles in the field of financial cooperation, compared to the IMF that focuses on economic and financial problems caused by the international payments imbalances. And also, it is necessary to impose a duty of compliance through multilateral agreements so that the matters presented as an execution plan by the G-20 may be complied with.¹¹ However, in reality, the action plan announced recently has a weak point that it is not able to impose compulsory duties on the participants.

Recently, the FSB has come into the spotlight in connection with the roles of the G-20 in financial stability. The FSB is not an affiliated organization of the G-20 as it was settled down in the developing process of the Financial Stabilization Forum into a Board, but its prestige has been raised as it plays the role of reporting about financial stability at the G-20. The function of the FSB includes assessing vulnerabilities affecting the financial system, promoting co-ordination and information exchange for financial stability, monitoring and advising for regulatory policy, setting guidelines for supervision, supporting contingency planning for cross-border crisis management, collaborating with the IMF to conduct Early Warning Exercise and reporting to IMFC and the G-20 Finance Ministers and Central Bank Governors on the financial stability.¹²

II. Establishment of East Asian financial cooperation system and possibility of intensification and other issues

A. History of discussion about East Asian financial cooperation

The discussion about the East Asian financial cooperation has a short history. The

¹¹ Daeki Lee, above n9, at 7.

¹² Declaration on Strengthening the financial system – London, 2. Apr. (2009).

discussion about the financial cooperation in the East Asia had not been activated until the foreign exchange crisis began in 1997.¹³ But the discussion about the common interest of the countries in the region began in earnest, based on the need of financial cooperation in the East Asian region due to the outbreak of the foreign exchange crisis.¹⁴ The first discussion was about the Asian Monetary Fund, which was suggested by Miyazawa-Initiative from Japan, during the IMF conference in Hong Kong in 1998. However, the discussion could not make progress due to the objection by the advanced countries and the IMF for the reason that it was not helpful for the stabilization of the international financial system.¹⁵ But at the time, the necessity of new financial cooperation system in the East Asian region had already been widely recognized, so the effort to find a financial cooperation plan could keep going even after the failure of the AMF initiative.

In the summit meeting of ASEAN + 3 countries, held in Manila in 1999, the head of each country agreed on the need to prevent the foreign exchange crisis in the region through mutual assistance. In order to give shape to this plan, the finance ministers of ASEAN countries and the three major countries in East Asia, such as Korea, Japan and China, got together in Chiang Mai in 2000, so the Chiang Mai Initiative could be announced, which was aimed at the conclusion of currency swap agreement among the countries in the region, so that foreign exchange liquidity could be supplied quickly in case of a foreign exchange crisis in the region in the future. In July, 2001, Korea and Japan concluded the bilateral currency swap agreement, and the agreements between Korea and China, China and Japan were concluded in June 2002 and March 2002, respectively.¹⁶

Besides the fund raising work to supply liquidity in emergency, the joint supervision system for financial stability, such as the ERPD, was established, and also the intensification of mutual assistance system in terms of international policies was carried out so that it might be possible to present a proper countermeasure in case the international finance market is unstable, or prepare policy means to prevent such cases. On the other hand, besides the establishment of fund raising and supervision system, the Asian Bond Market Initiative was declared as part of the policy for finance market activation through the finance market mechanism in the region, and the Asian Bond Fund was established for a measure on the demand side to promote the plan.

B. Development of Chiang Mai Initiative and directions for the future

The Chiang Mai Initiative(hereinafter referred to as CMI) has provided an important turning point which has become starting point of the East Asian financial cooperation.

¹³ Bokhyun Cho, above n1 at 124-125; Cho Jungran, 'Japan's Position about the Discussion on East Asian Economic Integration', 10(2) *International Area Studies*, at 281.

¹⁴ Kim, Youn-suk, 'Rationale for an Asian Monetary Fund, 3(2) *The Journal of the Korean Economy*'(Fall 2002), at 353.

¹⁵ Choi, Seung Pil, 'Die Unabhängigkeit einer Asiatischen Zentralbank, Uni. Würzburg, Würzburg, (2006), at 19; Fukushima, 'Challenges for Currency Cooperation in East Asia', 2, 10 *Research Conference Paper of Tokyo Club Foundation for Global Studies*, (2004), at 11-12; Jin, Chang-soo, 'Japan's Foreign Economic Policy: Return to Asia?', 12(3) *New Asia*, at 58. However, the IMF and the United States suggested that there would be no more objection based on the premise that the regional monetary organization would make a cooperation relationship with the existing order. See Rose, Andrew K, 'Is there a case for an Asian Monetary Fund?', *FRB-SF Economic letter*, (1999). On the other hand, it was indicated that one of the reasons the proposal was not promote was the failure to obtain the cooperation from China. The proposal of AMF was led by Japan without cooperation with China., Eisuke Sakakibara, 'Financial Cooperation in East Asia and Korea, *KITA distinguished lecture forum*(Nov.2003), at 14.

¹⁶ The Chiang Mai Initiative and the details of conclusion of currency swap agreement according to the initiative will be covered in the following pages.

Originally, there used to be a system called ASA(ASEAN Swap Arrangement)¹⁷ among Asian countries, in which a short-term loan was provided for the countries that needed capital due to lack of liquidity and current account deficit, but after the foreign exchange crisis the Chiang Mai Initiative became the major monetary cooperation system as Korea, China and Japan positively took part in the economic cooperation process under the name of ASEAN + 3. Looking into the characteristic of the cooperation system, it can be confirmed that the CMI is the bilateral agreement system where specific support scale and support condition are designated by the bilateral agreement while the ASA is carrying out fund supports in small scales based on the multilateral agreement. And the scale of financial resources reaches the level of US\$ 120 billion.¹⁸

When funding with the money offered through the bilateral swap agreement network, which was established by the CMI, the 80% of the total amount of swap transaction, excluding 20% of the amount, is provided with consent of the IMF. The initial swap period is 90 days, and in case of need it can be renewed six times within a maximum period of 2 years.¹⁹

In order to help the existing CMI system to settle down as the financial cooperation system in the region, we need to review several matters.

Firstly, we need to review the uncertainty of implementation of bilateral agreement. It is because a fund provider takes no legal responsibility for the fund supply, and whether or not to implement the fund support is based on its free will, despite the conclusion of bilateral agreement.²⁰ Even from a legal point of view, swap agreements are not in shape of treaty, which has binding power of reciprocal obligation between countries, but in shape of contractual agreement between central banks. This implies that the swap agreement is not a nation-to-nation treaty, which is incorporate character-based agreement, but a person-to-person contract.²¹ Accordingly, it was difficult to secure the binding power in reality when compared the duties under international treaties. So, it was required to convert it into multilateral agreement and also convert certain part of the content related to contract implementation into obligations. In the 8th ASEAN+3 Finance Minister Meeting held in May 2005, the participants agreed on the conversion into CMI-Multilateralization (Post-CMI) in order to prepare a procedure, and also agreed on introduction of collective decision-making mechanism into the CMI system operation, regarding it as a mid-stage.²² And it is an inspiring phenomenon that the agreement²³ on the official launch of Chiang Mai Initiative Multilateralization(CMIM), which is a multilateral system, was carried out at the 12th ASEAN+3 Finance Minister Meeting in May 2009, in Bali. In this manner, the agreement, which used to have characteristics of contracts between central banks, became able to raise funds through official multilateral treaties. Two core factors were included in this agreement. One of them was the allotted amount and the other was the method of decision-making. The

¹⁷ In the case of ASA, actual swap took place only five times, and it was estimated that the ASA could not make a big contribution to the foreign exchange crisis actually due to the small funds. Jo, Yong-gyun, 'Significance and Prospect of East Asian Financial Cooperation', Policy Studies Series, Institute of Foreign Affairs and National Security (2004-1), at 10-11.

¹⁸ As of April 2009, the fund retained by the ASEAN + 3 was US \$ 90 billion, excluding US \$ 2 billion of the ASA, but in the 12th ASEAN+3 Finance Minister Meeting, the type of fund was changed into multilateral fund as the fund size was increased up to US & 120 billion.

¹⁹ Yun, Deok-ryong, 'Chiang Mai Initiative: Present status and Improvement' *KEIP World Economy*, (September 2005), at 56.

²⁰ Yun, Deok-ryong, *Ibid*, at 56.

²¹ It was impossible to deal with detailed contents because the contents of swap agreement between countries were not publicized.

²² Article 6(II) of The Joint Ministerial Statement of the 8th ASEAN+3Finance Ministers' Meeting, Adopted on 4 May 2005

²³ Article 8 of The Joint Ministerial Statement of the 12th ASEAN+3Finance Ministers' Meeting, Adopted on 3 May 2009.

The allotment rate of CMI for Korea, China and Japan were 16%, 32%, and 32%, respectively, and the portion of allotment for three countries amounted to \$960 as the total was \$1200. And the ratio among three nations was 2:4:4, releasing the conflict between Japan and China over the initiative.

ratio of allotted amount may exert a great influence on the direction of funds, implying the influencing power of the relevant country in the CMIM. And the tool for securing the justice of decision-making for the fund operation have been obtained by adopting the collegiate system for fundamental issues, and the majority rule for lending issues.

Based on the multilateralization of the CMI, it may be assumed that the CMI is functioning as the AMF in limited aspects in actual fields. But there still remains a process in which an operational system shall be furnished, including an executive office so as to change the CMI into the AMF.²⁴ Furthermore, in order to secure the cause of fund support, it shall be accompanied by efforts to raise transparency and to avoid moral hazard shall be. Especially, it is natural that the close reviews on the macro-economy system of the country borrowing fund would be the data with which the fund support is decided. So, it is required that the requesting, providing and opening of data, in the similar process executed by the IMF, shall be carried out, and establishment of an organization where the resources shall be analyzed.²⁵ And the establishment of Dispute Settlement Unit shall be considered to solve problems in case of a conflict over violations of agreement.

Secondly, the small scale of fund supply is another problem. In the case of the fund supply scale through bilateral agreements, it could just reach the level of US\$ 120billion even after the conclusion of multilateralized agreement. In consideration of the fact that the integration of financial market accelerated due to the increase of financial cooperation in the region and the expansion possibility of financial market, it may not be regarded as enough amount of fund.

Thirdly, as the amount available to use without consent of the IMF in the CMI system is merely at the level of 20% of the total swap size²⁶, the lending of the remaining 80% is accompanied by the conditionality in accordance with the lending system of the IMF. However, recalling the fact that the establishing purpose of financial cooperation in the region was mainly related to the complicated support condition under the existing international financial order in emergency, it seems contradictory that most funds shall comply with the existing conditionality in the regional fund support system. This is closely related to the second item, and if the operation of this system continues with the limited fund size in the existent circumstances, the shortage of fund shall depend on the lending program of the IMF, so the system will be limited to the structure functioning as a subsidiary means of the lending system of the IMF.²⁷ On the other hand, the problem, which emerges when the free fund from the conditionality of the IMF remains at the 20-percent level, may be defined as the limitation of fund support capability for prior prevention. The fund support from the IMF is carried out when a crisis becomes a reality, so when the support is ready, the market already has lost its function, then the support mainly focuses on the restoration. However, the regional monetary cooperation fund also includes the goal of prior prevention besides the restoration, so the current rate, 20 percent, is regarded too small to achieve such goals.²⁸ But it is assumed that the connection between the IMF and CMIM also has a positive aspect as it is raising the credibility of the CMIM, so the cooperation with other international organizations, including the IMF, is regarded as an important matter.

As for the cooperation relations with other international financial organizations, including

²⁴ Oh, Yong-hyeop/Oh, Seung-whan, 'The significance and suggestion from the multilateralization of the CMI', *World Economy Update*, KIEP, 11 May 2009, at 3.

²⁵ Yun, Deok-ryong, above n19, at 58.

²⁶ In the existing system, the rate was no more than 10%, but it was raised by 20% in the 8th Meeting in order to cope with the anxiety of the regional financial markets in the emergency. Article 6(IV) of The Joint Ministerial Statement of the 8th ASEAN+3 Finance Ministers' Meeting, Adopted on 4 May 2005.

²⁷ Yun, Deok-ryong, above n19, at 58.

²⁸ Sohn, Injoo, above n2, at 3.

the IMF, the CMI has clearly stated that it is carrying out the supplementary role for the existing international system under cooperation relationship with existing international organization, including the IMF.²⁹ In reality, it must be acknowledged that IMF has the function of mediator in the worldwide financial market as the root and the trunk of international financial cooperation organizations. And, as long as the regional financial measures in East Asia have an effect on the other areas due to the intensification of relationship among global finance markets, it is reasonable to recognize the prestige of the IMF. However, it is required to convert the relationship between the CMI and IMF to a strategic partnership based on the fact that the most important purpose of the CMI is to get over the problems caused by the instability and insufficiency of the programs against liquidity crisis, which have been provided by the existing international financial system. As a concrete strategy, it may be suggest that the fund size the CMI can determine by itself should be expanded, and at the same time, the size of fund support and the application range and level of the conditionality should be determined at the regional cooperation system in which the IMF participates, according to the situation of the borrowing country. The only thing to pay attention to in this process is that the more the amount out of conditionality increases, the higher the possibility of moral hazard rises, so it should be accompanied by the countermeasures to prevent such moral hazards.³⁰

C. Cultivation of Asian bond market

A development of bond market may form a foundation for smooth flows of fund and promotion of transactions in that it is corresponding to the development of fundraising market for the relevant country or enterprises. Accordingly, it has a great significance in the aspect that it is related to fund raising and application of the accumulated funds. And in the long run, it will contribute to the cultivation of bond market for the development of regional finance.³¹ Besides, the important thing is the problem of mismatch, which is contained in bonds. In reality, the Asian bond markets, except for Japan, have the double risk defined as 'currency & maturity mismatch' due to the underdevelopment of bond markets³². Actually the problem of mismatch was partly responsible for the 1998 foreign exchange crisis.³³

And also, the aspect of effective management of the abundant foreign exchange reserve in Korea, China and Japan was involved in the issue. Based on the actual background, the Asian Bond Markets Initiative (ABMI) and ABF(Asian Bond Fund were discussed for the first time in 2002, by the member nations of EMEAP(Executives' Meeting of East Asia and Pacific Central Banks).³⁴

The AMBI is playing the role of Supply Side in cultivation of Asian bond markets. The major contents of the AMBI focused on construction of the Asian Guaranty Facility³⁵, rating agencies and regional settlement and clearing systems based on issuing bonds in the region,

²⁹ Article 5 of The Joint Ministerial statement of the 8th ASEAN+3 Finance Ministers' Meeting, Adopted on 4 May 2005.

³⁰ William W. Grimes, 'East Asian Financial Regionalism and U.S. National Interests', *E-Notes*, <http://www.fpri.org>, at 5.

³¹ In the case of east Asian countries, despite the cultivation needs for regional finance market after the foreign exchange crisis, the path to the stable long-term fund raising was not formed due to unripe bond market, especially the long-term bond markets., Richard J. Herring/Nathporn Chatusripitak, 'The Case of the Missing Market: The Bond Market and Why It Matters for Financial Development', *II, ADB Institute Working Paper*, July 2000.

³² Jie Sun, *The Asian Bond Market: Background, Progress and East Asia*, 36(2) *Regional Development Studies* (2004), at 5.

³³ Park, Joeng-pil, 'ABF Operation Status of EMEAP and Future Task', *Review of International foreign exchange finance*, Bank of Korea, December 2005, at 116.

³⁴ EMEAP consists of 11 central banks, Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, and Thailand.

³⁵ In the ASEAN+3 Finance Ministers' Meeting held in Bali in 2005, the establishment of Credit Guarantee Investment Mechanism was agreed, as a credit guarantee facility. The initial fund of this organization was supposed to be raised at the level of \$500 million.

eliminating transaction barriers and promoting contributions from participants as substructures.

Another important part in bond market cultivation is purchasing power. The ABF was set up in consideration of 'Demand Side'. Though lots of good-quality bonds were issued in the region, they would not activate the bond market if they could not be purchased. In this respect, the ABF has a different meaning from currency swaps that is aimed at supplying liquidity in case of financial crisis. The ABF is composed of the ABF1 (launched in 2003), which invests in dollar-denominated bonds, and the ABF2 (launched in 2005), which invests in currency-denominated bonds.

The legal form of the ABF may be defined as In-house Fund of BIS which has been in charge of entrusted management of the fund. There are several reasons why the ABF is composed of the In-house Fund of the BIS. Besides the consideration of security and raising credit rating making use of the fame of BIS, the biggest reason was about whether the invested amount in the ABF could be accepted as a foreign exchange reserve. According to the BoP (Balance of Payment) manual of the IMF, the amount invested in the ABF was defined as other foreign currency assets and classified as a kind of claim. In order to be accepted as a foreign exchange reserve, it has to satisfy the standard of International Reserve and Foreign Currency Liquidity: Guidelines for a Data Template, presented by the IMF. According to this standard, it has to satisfy the conditions of liquidity and marketability, financing of payment imbalance, currency convertibility, but once a participant invests in the ABF, an immediate encashment is not allowed, in other words, the problem occurs in liquidity and marketability. Therefore, in order to solve this problem the EMEAP has prepared a system, in which any redemption can be carried out based on asking the BIS for the asset at any time, by designating the BIS, which has high credit rating, as the fund manager and concluding the agreement similar to a sort of trust agreement.

On the other hand, in respect that the ABF1 invested in dollar-denominated bonds, there was no problem in currency convertibility. However, in case of the ABF2, problems occurred in both sides due to the investment in regional currency-denominated assets. Based on such situation, the ABF2 also designated the BIS as a legal investment body, having the participating countries obtain the shares from investment account of the BIS. Therefore, in case a participating country wants to withdraw the fund, it can secure the fund by selling the share from the BISIP (BIS Investment Pool)³⁶ of the BIS.³⁷ The issue of foreign exchange reserve like this shall be solved in priority when the cooperation in the East Asian bond market makes progress and the fund is operated as an independent fund, not the In-house Fund of the BIS, in the future.

Another important problem in connection with the cultivation of the Asian bond markets is the unification in the field of legal institutions. The uniformity of regulation systems and rearrangement of regulations in tax laws, including accounting system, may be regarded as preconditions.³⁸ As for the accounting system and tax laws, the issue is the double process of capital income tax and taxation of dividend. So to speak, the profit sharing based on fund operation and taxation standard for capital profit vary from country to country, so it is functioning as a barrier against free bond transaction. As for the bond issuing for non-residents, it is necessary to set up unified regulations as bond issuing is regulated complying with domestic law of each country.³⁹ However, such process of legal integration

³⁶ The assets in the BISIP are denominated and traded in USD.

³⁷ Park, Jung-pil, above n33, at 129, 136.

³⁸ Jie Sun, above n32 at 11; Jang, Wonchang, 26(4) Economic Research, at 269.

³⁹ Mamiko Yokoi-Arai, 'Legal and political effects of financial and monetary-Regional integration in Asia', *Law and Business Review of the America* (Winter 2006), at 67-69.

has a difficult point that the level of legal regulation varies considerably in accordance with development degree of individual bond markets. According, it is considered that it may take time to raise the regulations up to same level by degrees. Besides, providing settlement and liquidation function in connection with bond transaction is the compulsory requirement as well. So, the standardization of settlement system is also the task to be settled before-hand.

D. Intensification of function of ERP(D(Economic Review and Policy Dialogue)

The ERP is an organization established to intensify policy discussions, coordination and cooperation in management of financial, monetary and fiscal affairs among member nations of ASEAN+3, carrying out surveillance function. The main function of this organization is centered on risk management under macro-economy system, monitoring capital flow, intensification of financial system and promotion of joint cooperation in the region. This implies that the organization is working as a regional cooperation system, limiting the partial object of the functions of international monetary organizations to the region.⁴⁰

The part especially emphasized among the roles of ERP is about monitoring flow of short-term capitals. It is because the movement of short-term fund will be very fast in case of a progress in financial cooperation and opening of regional finance market. For example, in case the Asian bond market is opened according to the cultivational paradigm, it will be accompanied by permissions of inflow and outflow of non-residents' capital, so it may cause a problem of capital balance due to the movement of short-term capital. Accordingly, without an introduction of proper regulation in the range that is not limiting the monitoring function and transactions, it might bring about a great setback in the macro-economy operation. So, the monitoring function in the market against speculative funds, proper response to such funds and the mechanism of cooperation to deal with such funds are compulsory functions.

However, like other financial cooperation systems in the East Asia, the ERP is nothing but an entity based on the agreement for financial cooperation in the regional market, so it does not retain a corporate personality itself, or have a form of international organization. With the entity based on the characteristics of cooperative agreement, a limitation is placed in the function to draw positive cooperation in macro-economy and finance supervisory policies in the region, and create guidelines with normative characters. So, in case of big progress and intensification of Asian financial cooperation, it may be required to include the ERP in the AMF, or convert it into an official economic organization in the region.

E. Establishment of the AMF and mutual assistance among the existing international financial organizations

There are various standpoints for or against the establishment of the AMF. The major basis of arguments of the opposing party lies in the fact that it would be difficult to carry out a unified international finance market regulation due to the establishment of the AMF. In short, they argue that in case the IMF and AMF are taking opposite standpoints, the policy effect will reduce by half and do harm to the international financial order instead. On the other hand, the major basis of arguments for the establishment of the AMF lies in the hypothesis that the function of the IMF as the Lender of Last Resort can not supply enough liquidity in case of multiple occurrence of financial crisis at a time, and secondly a foreign exchange crisis spreads among the regional countries at the first stage and the most damaged are the regional countries which have intensified connection with others based on the regional characteristics,

⁴⁰ Bok-hyun Cho, above n1, at 131.

and thirdly the institutions in the relevant area retain the access to better information about the relevant region. In short, the point is that the relevant regional institutions can present countermeasures that are faster and suitable for the region.⁴¹ It seems that everybody recognizes the need of AMF based on the views of regional countries toward the AMF. However, so far there has been no concrete discussion about how to decide the stand and function of the AMF and establish the relationship with existing international organizations.

As for the establishment of the AMF, it is very important to decide how to build up the function. It is because the roles as a regional organization is decided by what function is given to it, and according to the function the connection with the existing international organizations is demarcated.

Based on the substance of monetary fund, the function of the AMF seems not to be much different from that of IMF. In general, compared to the function of the IMF, the functions that the AMF should have may be the function of Lender of Last Resort, carrying out various statistical surveys, and the function to present guidelines for exchange rate stability. The currency swap based on the Chiang Mai Initiative may be achieved by expanding the partial function of Lender of Last Resort, and the function of surveillance⁴² and statistical surveys can be achieved by expanding the function of the ERPD. However, whether to include the parts additionally, which the IMF does not retain now but makes effort to obtain — supervisions by financial institutions⁴³ — is the field to be reviewed again.

IMF shows currently much interest in the field of financial supervision. But in the situation where there exists no integrated international organization for financial supervision, the international regulations of soundness supervision have been established as the regulations on banks and securities companies were led by the BIS and the IOSCO, respectively. However in the reality where the integration of capital market became the worldwide trend and the need of integrated international supervisory organization is suggested, it may be regarded as an effective measure for financial market stabilization to impose the role as a financial supervisory organization on the function of AMF. On the other hand, in case the AMF carries out the similar roles of the IMF and other financial supervisory organizations, the relationship with the existing international organizations like the IMF, BIS and FSB becomes very important. And in order to get over emergencies, it is required to maintain a continuous mutual assistance under cooperative relations, not replacing them by other organizations.⁴⁴

F. Regional FTA and acceleration of financial cooperation

Today, the degree of dependence upon foreign trade among regional countries year after year, so the East Asian countries, including Korea, China and Japan, are showing great interest in conclusion of the FTA. So far, Korea, China and Japan have focused on the conclusion of FTA with Southeast Asian countries, but the three countries have been carrying out internal reviews on promotion of the FTA among the countries since several years ago.⁴⁵ In case Korea, China and Japan promote the mutual FTA, it will bring about the effect of free

⁴¹ See Kawai, Masahiro, 'Regional Economic Integration and Cooperation in East Asia, *Expert Seminar on the "Impact and Coherence of OECD Country Policies on Asian Developing Economics"*, OECD, (2004).

⁴² In order to operate the financial resources of AMF effectively, such a function of surveillance is very important, and the AMF has a merit that it has the privilege in execution of region-based surveillance based on the superior regional knowledge, Kim, Youn-suk, above n14, at 364.

⁴³ As for regional financial supervisory organization and the establishment of supervisory system, the studies on the matter were entrusted to working level groups at the ASEAN +3 Finance Ministers' Meeting held in May 2005.

⁴⁴ Kim, Youn-suk, above n14, at 364.

⁴⁵ The East Asia study Group has taken the formation of East Asia Free Trade Zone as the mid-long-term project. Financial Report East Asia Study Group, November 2002, <http://www.mofa.go.jp/region/asia-paci/asean/pmv0211/report.pdf> (visited 15 June 2009).

trade area establishment in the ASEAN+3 region. And if a finance sector is included in the FTA, it will provide a room in which the regional financial cooperation comes true naturally through the FTA. It is because the opening market will be accompanied by institutional cooperation, so that the barrier in terms of law may be eliminated and the regulations at the same level will naturally induce the institutional integration.⁴⁶

Present status of the FTA promotion among Korea, China and Japan
(based on the Asian region)

	Conclusion and Agreement	Under negotiation or joint study
Korea	Singapore, ASEAN	Japan, Thailand, Malaysia, china
Japan	Singapore, Malaysia, Philippines, Thailand, Brunei, Indonesia, Vietnam, ASEAN	Korea
China	ASEAN, Hong Kong, Macao, Singapore, Thailand	Korea

Data source : The contents from <http://aric.adb.org/FTAbyCountryAll.php> were edited by the researcher (as of June 15, 2009.6.15)

In case the FTA includes financial sectors as well as the commodity trade, the mutual opening of financial sectors will bring the integration of institutions into mutual finance markets, as well as promoting capital movement, so it may help the countries have the same level of regulation or regulative policies. Besides, the financial cooperation through the FTA brings about the intensification of politically mutual assistance as well as the change in the systems, by presenting the need of joint countermeasure against the side effects due to the free movement of capital in the region, namely the rapid change in capital balance caused by the short-term movement of the capital.

G. Discussion about the possibility of introduction of common currency system

The final stage of currency and financial cooperation would be the establishment of a common currency system like the EU. According to the paper of Mundell, titled 'A Theory of Optimum Currency', the East Asian region has been equipped with enough factors to build up a common currency bloc with.⁴⁷ But there are both positive and negative evaluations as to whether to introduce the common currency system or not. As positive factors, there are some indications, such as reduction in transaction costs in regional trade and capital movement, avoidance of risks due to a change in foreign exchange rate, benefit from a synergy effect based on the integration of finance market, and reduction of financial costs. Besides, the indirect function of dispute control in the region may be included in the discussions. On the other hand, as the negative aspects, there are some arguments, such as loss of business cycle control means due to handover of currency sovereignty, limitation in counterplot in case of economic emergency due to the loss of Lender of Last Resort function, and the loss of seigniorage⁴⁸.

⁴⁶ Sohn, Byeong-hae, 'Ideal East Asian Regionalism in the Tri-polar Trading System', 9(2) *International Trade Research*, at 30-31.

⁴⁷ See ADB, 'Monetary and Financial Cooperation in East Asia, 2002; Madhur, Costs and Benefits of a Common Currency for ASEAN', 12 *ERD Working Paper Series*, (2002); Lee Jong-wha/ Park Yung-chul/Shin Kwan-ho, 'A Currency Union East Asia (Background Paper for ADB)', *Study on Monetary and Financial Cooperation in East Asia*, (2002).

⁴⁸ Kyunae Ahn, 'East Asian Economic Integration and Currency Unions: Interests and Roles of China-Japan-Korea', *The Journal of Social Paradigm Studies*, at 86.

The establishment of common currency system implies that the common currency credit policy, foreign exchange policy and the macro-economy control policy have been achieved. In this procedure, the currency sovereignty shall be transferred, and the foreign exchange reserve shall belong to the Asian Central Bank, which will be newly established like Europe. And like 'The Stability and Growth Pact' in the European Currency Community, the liberty may be limited in the aspect of fiscal policy, including limitation in the fiscal deficit size. Accordingly, it is natural that there will be sharp confrontation over the interests among participating countries, requiring a long time and gradual approach after all.⁴⁹

Talking about the gradual approach, in the case of the EU, the participants proposed certain period related to convergence criteria as to the institutional details of currency system, allowing a period of time to achieve the system. And they claimed the amendment of legal system in each country in time through the EC Treaty, Regulations and Directives.⁵⁰ Especially, the soundness of fiscal operation, construction of foreign exchange rate mechanism, and the independence of the central bank were core part of the procedure.

As seen in the previous pages, the need of common currency system has enough propriety itself, and it is recognized in that way, so the necessary measures on the path to the common currency system are coming into being indirectly in the process of financial cooperation. However, in case of a competition between Yuan and Yen as a common currency, it might bring about difficulty in cooperative systems, connected to the political and historical problems. At the end of 2007, China started the efforts to make the Yuan a key currency since holding the international symposium hosted by the HongKong Currency Bureau, and Japan has been making the same efforts. But it is considered that such currency discussions as Yenization and Yanization will be the biggest problem in execution of the Asian common currency system.⁵¹

IV. Conclusion

The big framework of the East Asian financial cooperation may be divided into 4 stages. The first stage includes the currency swap agreement, the second includes the multilateral currency swap agreement, the third stage includes the Asian Monetary Fund, and last one is the stage of Asian Common Currency System. The current stage of Asian financial cooperation seems to have passed the first stage and transfer to the second one.

Looking into the 4 stages of development, we can recognize the cooperation in approaching institutional aspects. The approach in the institutional aspect is a process where the systems with different standards in financial sectors are developed into one standard. So, it may be regarded as not too difficult in the respect that the contact point may be found out through the standard schemes of international financial organization lie the IMF. However it is expected that there will be a fierce debate.

On the other hand, another obstacle in the development in financial cooperation system in the East Asia is related to the historical and political problems. Especially, the historical and political conflict among Korea, China and Japan seem to be a great obstacle in the construction of Asian financial cooperation system. Accordingly, in order to achieve the East Asian financial cooperation system, various exchange and close cooperation shall be supplemented, besides the substantial financial cooperation among the three countries.

⁴⁹ Choi, Seung Pil, 'Die verfassungsrechtliche Grundlage der makroökonomischen Politik der EU', 1 *European Constitution*, (June 2007), at 140.

⁵⁰ See EWU, *Konvergenzbericht (nach Artikel 109j EGV a.F.=Article 121 of EGV des Vertrags zur Gründung der europäischen Gemeinschaft vorgeschriebener Bericht)*, Adopted on March, 1998.

⁵¹ Choi, Seung Pil, above n15, at 17.