3 IMF and ADB perspectives on regional surveillance in East Asia

Gordon de Brouwer

East Asian policy dialogue on economic and financial developments within the region and beyond it occurs in a range of forums. These include the APEC Finance Ministers' Meeting, the ASEAN+3 Finance Ministers' Meeting, the ASEAN Finance Ministers' and Governors' Meetings, the Manila Framework Group (MFG), the Executives Meeting of the East Asian and Pacific Central Banks (EMEAP), the China-Japan-Korea Finance Ministers' Meeting, and the Four Markets Group. There is consensus in the region that there are now enough forums for policy dialogue. But there is also general agreement that many of them do not fulfil their potential as forums for substantive and effective economic monitoring and surveillance. In this context, there is an appetite to reform and strengthen some of these forums, especially the ASEAN+3, ASEAN and MFG meetings.

This chapter looks at ways to strengthen monitoring and surveillance in regional policy dialogue from the perspective of the International Monetary Fund (IMF) and the Asian Development Bank (ADB). These institutions are the core providers of much of the intellectual and logistic support for many of the meetings. They are involved in many meetings, either as presenters on recent developments or as observers. They also have their own views on, and their own interests in, the processes. The way they perceive regional surveillance may influence the way regional arrangements evolve. And as regional arrangements evolve, the roles they play may also change.

The chapter is structured in the following way. The first section looks at IMF perspectives on regional surveillance. The next section looks at ADB perspectives. The final section critically examines some elements of these different perspectives. Because the regional debate on surveillance is still developing, the chapter also sets out some guidelines for how the region should assess the role of different institutions in regional debate.

IMF PERSPECTIVES

The IMF lives and breathes surveillance. Economic and financial surveillance of member countries is one of its key functions:

One of the core responsibilities of the IMF is to maintain a dialogue with its member countries on the national and international repercussions of their economic and financial policies. This process of monitoring and consultation is normally referred to as 'surveillance', though there is nothing clandestine about it. Indeed, the consultation process has become increasingly open to public scrutiny in recent years. (IMF 2003: 1)

Surveillance has become more important over time, as economies have become more sophisticated and complex and as the connections between economies grow. Interdependencies within each economy and interdependencies between economies are expanding, and so the process of monitoring and debating countries' economic policies will remain important.

In recognition of this, the IMF has its own surveillance processes as well as participating in surveillance processes elsewhere, including in Europe and Asia. Let me consider the IMF's own surveillance processes first. The IMF's mandate to conduct surveillance comes from its Articles of Agreement, using surveillance to assess 'whether a country's economic developments and policies are consistent with the achievement of sustainable growth and domestic and external stability' and, more broadly, international stability (IMF 2003: 1).

The IMF conducts its own surveillance through three main mechanisms. The first is a general process of regular interaction, normally every year, with the key authorities of member countries through the Article IV consultation process, according to which:

These consultations focus on the member's exchange rate, fiscal, and monetary policies; its balance of payments and external debt developments; the influence of its policies on the country's external accounts; the international and regional implications of those policies; and on the identification of potential vulnerabilities. (IMF 2003: 1)

More controversially, they may also cover related policies which have macroeconomic consequences, like labour and environmental policies.

The second mechanism is the IMF's own reporting on economic and financial issues. The IMF's World Economic Outlook and Global Financial Stability reports provide opportunities for discussing developments and policies in key countries.

The third mechanism is through IMF lending programs to support adjustment in member countries, although this is usually referred to as conditionality. When the IMF extends its lending facilities to a country in need, it closely monitors and assesses domestic economic and financial developments. This can involve placing IMF staff on the ground in the country concerned. This is not what is ordinarily meant by surveillance; the debate about the suitability or otherwise of IMF programs is separate.

Following the various national and regional financial crises that have occurred in the past decade, the IMF has worked on ways to improve its

surveillance. It regularly reviews its surveillance internally (IMF 2002a, b). Surveillance is also on the work program of the IMF Evaluation Office. The IMF highlights four ways in which it is strengthening surveillance (IMF 2003: 2).

The first is by improving the information provided by countries, especially with regard to timeliness, reliability and comprehensive coverage. The IMF's Special Data Dissemination Standards (SDDS) set out a benchmark for countries with capital market access to release key market information in an open and consistent manner. The information includes data on external reserves, cross-border liabilities, and short-term external debt.

The second is through improving the continuity of IMF surveillance. One East Asian criticism of the Fund in the late 1990s was that one visit one week a year was not sufficient for IMF staff to understand the complexities of the local economy and institutions and how decisions are made and put into effect. To improve continuity, the IMF has supplemented annual consultations, with interim staff visits to the country concerned and frequent informal meetings of the Executive Board to review developments in selected countries.

The third is to widen the focus of surveillance beyond the standard macroeconomic fundamentals to other aspects of vulnerability. These include a closer and more detailed examination of the financial sector, capital account issues, and external vulnerability (including aspects of policy interdependence and risks of contagion).

The fourth area pursued by the IMF has been to clarify basic international standards and enforce their observance. These include monetary and fiscal codes, codes for the financial sector and codes for data transparency. By monitoring countries' observance of international standards, there are increased incentives to adopt and improve adherence to such standards. In this context, the IMF and the World Bank have set up a Financial Sector Assessment Program (FSAP) and adopted a program of Reports on the Observance of Standards and Codes (ROSCs) (IMF 2003:2). Many of these ROSCs are published.¹

The IMF is also involved in the internal surveillance processes of other countries or regions. Examples are IMF attendance at the G-7, the Organisation for Economic Co-operation and Development (OECD) and the Bank for International Settlements (BIS). In East Asia, the IMF is an active participant and presenter in the meetings of APEC Finance Officials, ASEAN and the MFG.

The involvement of the Fund in regional policy dialogue is motivated by a number of factors. The IMF has established expertise in macroeconomic surveillance, as well as the staff and financial resources to support it. Being able to draw on the experience of a big pool of countries over time enables the IMF to speak with authority about macroeconomic and financial issues. The IMF also has responsibilities for global financial stability; being involved in regional surveillance dialogue enables it to better assess vulnerabilities in systemically important economies and regions.

The IMF is active in promoting effective monitoring and surveillance in East Asia. It also closely follows the way a regional financial architecture in East Asia is developing and how it is likely to evolve over time. The ASEAN+3 process is of most interest in this respect. The ASEAN+3 work program includes developing a regional cooperative financing arrangement, improving regional surveillance mechanisms, and exploring options for stronger monetary cooperation in the region. These cut across some of the core functions of the IMF. So far, they have not done so in a way which undermines the IMF. For example, the Chiang Mai Initiative (CMI) requires IMF conditionality (or the likelihood of such conditionality) before 90 per cent of available funds can be disbursed.

But it is possible that other aspects, especially with respect to surveillance, may develop in ways that give less prominence to the IMF. The IMF has played a central role in the MFG surveillance process. Given the regionalist motivations of ASEAN+3 and its aspirations for an effective regional architecture, it is unlikely that the IMF would be the central agency for surveillance in the ASEAN+3 process. The IMF thinks that five conditions must be met if the regional policy process is to be effective.

First, the objectives and purpose of a regional mechanism must be well defined. A regional mechanism is not an end in itself but is a means to the end of stable and strong economies. The ASEAN+3 grouping is intent on avoiding crises. That is a worthy aim but policymakers need to be clear about what they have to do to achieve it. Policymakers need to define what regional surveillance should do. It is not enough for ASEAN+3 to just be a BIS-style coffee house in which people can talk issues over gently.

Second, the focus of regional surveillance must be clearly defined. Surveillance can include sharing information, dialogue on key issues, and even giving policy advice. What does ASEAN+3 want its surveillance to include? The approach taken to dealing with these issues varies, depending on the content. Surveillance on macroeconomic issues is different from that on financial sector vulnerabilities, requiring different sets of expertise and knowledge, as well as different degrees of intrusiveness.

Third, the guidelines for regional policy dialogue on surveillance must be clearly understood and set out. These guidelines can either be general and outline broad policy objectives or be more specific, rules based and legalistic, like targets for fiscal policy. This is a choice that is up to the countries involved. The IMF has a mix of these in its surveillance process: ROSCs and FSAPs are more rules oriented than the more general Article IV process, which covers broader trends, developments and issues. In terms of its internal surveillance processes, East Asia has to work out whether it wants a general or specific form of surveillance.

Fourth, the relationship between regional and global surveillance must be clearly determined. To put this at its most provocative, one might ask why the region needs its own surveillance process when a global process already exists in the form of IMF surveillance. One needs to consider the advantages

of regional surveillance. The IMF does not subscribe to the view that the regional surveillance and financial cooperation will lead to Gresham's law of conditionality, with weak surveillance and conditionality pushing out strong surveillance and conditionality.

But the IMF does think that the advantages of global processes should not be ignored in the rush to find regional solutions. For example, proponents of regional dialogue argue that a regional mechanism boosts country ownership of policy and enables local institutional knowledge to be brought to the analysis and solutions of domestic economic and financial problems. But being local may also make it difficult to be completely frank about the problems a country is facing or to say no when it is right to say no. It can be useful to pass this pressure on to outsiders. Having outsiders with global experience involved in regional debate is also useful because it brings a wider set of insights to bear on problems. It is important not to be too dogmatic about the rights of regional surveillance and the wrongs of global (that is, IMF) surveillance. Ideally, the two can complement each other.

Fifth, effective surveillance mechanisms take time to develop, so speed is not of the essence. There is a lot to lay out in developing an effective regional surveillance mechanism. This means being prepared to be modest about what can be achieved in the short term. East Asia clearly wishes to move fast in developing regional processes. One should not, however, look at established cases, especially Europe, and just import their approach and techniques. Europe is relatively legalistic in its approach; it may be more useful for East Asia to adopt a practical approach tailored to its own circumstances.

ADB PERSPECTIVES

The ADB is also active in promoting and supporting economic surveillance in East Asia. It has pursued this through its Regional Economic Monitoring Unit (REMU), which was established in early 1999. REMU was established at the request of the ASEAN finance ministers to support the ASEAN Surveillance Process. The ADB sees REMU as part of the larger issue of regional monetary and financial cooperation (RMFC) in East Asia, encompassing information exchange and surveillance systems, regional resource and reserve pooling, exchange rate coordination, and domestic financial sector restructuring and reform.

The ADB's policy and research focus on the RMFC agenda was stimulated by the East Asian financial crisis. The ADB sees RMFC as not just a 'naïve shift to regionalism and desire to mimic Europe'. Rather, RMFC is motivated by at least four economic factors.

First, there is a desire to put in place an effective architecture to deal with the problem of cross-country contagion that occurred in the region in 1997 and 1998. The mainstream view in East Asia is that regional mechanisms to provide funds in a financial crisis can be an important complement to global mechanisms.

Second, there is a view that international liquidity is insufficient to deal with future crises, so the region needs to build up its own resources. An element of this debate is that the region's access to international liquidity has not always been fair, especially in the terms and conditions of the IMF support packages. In this view of the world, a regional mechanism is not just desirable but necessary.

Third, taken as a whole across East Asia, financial markets are not deep and sophisticated, financial institutions are not strong and robust, and financial governance is not well developed or fully effective. The region shares a common vulnerability in finance.² For a development bank like the ADB, this means that there is a big regional work program.

Fourth, exchange rate developments in one country affect other countries, especially those with close economic ties in the region: exchange rate spillovers matter. The ADB sees value in exploring whether there are economic gains from cooperation in exchange rate management in East Asia and how these gains, if they exist, can be realised.

Work on regional financial and monetary cooperation is still in its early stages. The ADB sees four areas in which this work will advance: strengthening regional surveillance; developing the cooperative financing framework set up in the CMI, including multilateralising the framework by, for example, the centralised pooling of reserves in the region; developing proposals for regional cooperation in financial sector restructuring; and exploring various ideas for cooperative exchange rate regimes in East Asia.

These issues are being debated and are not yet resolved. It is difficult to prejudge how they will evolve. In the short to medium term (out four to five years), the ADB thinks that there is a need for stronger regional monitoring and surveillance, increased regional coordination in financial sector restructuring and development, and cooperation in reserve pooling. However, immediate exchange rate coordination at the regional level through any type of tying in of intra-regional exchange rates is considered not only not desirable but also not feasible. Hence, it recommends that exchange rate coordination should be approached more cautiously and gradually than coordination in surveillance and reserves pooling, perhaps after significant progress has been made in these two other areas of cooperation and substantial trust-building and political consensus has been mustered.

The ADB sees substantial value-added to regional economic monitoring and surveillance (REMS) over and above what is already done by global-level institutions. Merits of REMS are many, but at least four of them deserve special mention.

First, it is conceivable that East Asian countries may be more willing to engage in a frank exchange of information with a regional body over which they exercise substantial direct control than with a global institution where they may exert relatively much less influence.

Second, a regionally specialised unit may also have the advantage that the producer and user of the information share a common analytical framework. Greater scope for specialisation in regional economic situations and development issues has been acknowledged by the international community in the broader area of economic development, for example, through the formation of regional development banks.

Third, countries in East Asia may simply find it useful to pass information about each other's economies through a different analytical filter from that of the global institutions. Regional differences in analytical perspectives and in the diagnosis on economic problems have always been important.

Fourth, because a specifically regional monitoring mechanism would provide a device for analysing developments within the region on the basis of an analytical perspective that Asian countries find congenial, the credibility and perceived usefulness of this information may be enhanced.

Overall, the ADB sees a role for 'properly structured and well managed' surveillance activities at the national, regional and global levels. They can complement each other. This leads to considering the actual and potential role of the ADB in regional economic monitoring and surveillance. Consider, first, its current role. Within the framework of advancing regional monetary and financial cooperation, the ADB (2003) defines the role of regional economic monitoring and surveillance to be to:

... assist the developing member countries of ADB – both individually and collectively – to harness the full benefits of global financial integration and international capital flows while at the same time minimizing any disruptive effects.

The REMU was set up to perform this monitoring within the ADB. It has three functions. The first is to monitor economic policies and financial architecture issues from a regional and subregional perspective and disseminate the results to promote prudential economic management. The second is to strengthen the capacity for economic monitoring at the regional and subregional levels by providing technical assistance and advisory services. The third is to strengthen the ADB's relations with other international financial institutions, as well as regional and subregional bodies, by providing monitoring inputs to various meetings and discussions.

The REMU seeks to achieve these functions by providing analytical and capacity building support to the ASEAN Surveillance Process and housing the Asia Recovery Information Center (ARIC).³

The ASEAN finance ministers signed a terms of understanding in October 1998 establishing the ASEAN Surveillance Process. Ministers requested ADB support. Based on the principles of peer review and mutual interest among ASEAN member countries, the ASEAN Surveillance Process is intended to strengthen policymaking within the ASEAN grouping. The process monitors sectoral and social policies as well as the usual parameters of exchange rates

and macroeconomic aggregates. It also includes provisions for capacity building, institutional strengthening, and sharing of information. The ASEAN finance ministers meet twice a year for policy coordination under the ASEAN Surveillance Process.

The ASEAN Surveillance Process is the first concrete attempt by a group of developing countries to exchange information on economic developments and policies, and to consider individual and collective responses to events that could negatively impact on subregional economic wellbeing. The ADB has set up a number of regional technical assistance projects to be implemented by REMU in support of the ASEAN Surveillance Process. These projects are to provide inputs to the ASEAN surveillance reports, conduct studies on specific topics, and strengthen the capacity of ASEAN officials and institutions on surveillance-related matters. Several of these technical assistance projects are already being implemented, one with co-financing from AusAID, the Australian Agency for International Development.

The ARIC concept first emerged at a meeting on development cooperation, 'Responding to the Asia Crisis', held in Sydney on 5 March 1999.⁴ This meeting gave high priority to the need for accurate and timely information on the economic and social impacts of the Asian crisis and how recovery was progressing. Such information was seen as being vital to decision-makers in making informed choices on how best to respond to the crisis and to sustain the recovery's momentum.

Acting on a proposal by the Australian Government, the meeting agreed that an Internet-based facility would provide the most efficient means of gathering, collating and disseminating this information. The Australian Government subsequently invited the ADB to house the ARIC at its headquarters in Manila, which ultimately resulted in the ADB approving a regional technical assistance project for this purpose that is funded entirely through a grant from AusAID.

The ARIC web site has three objectives.⁵ The first is to monitor the social and economic impacts of the Asian crisis and the recovery process with a view to making it easier to identify the remaining policy agenda for a sustained social as well as economic recovery. The second is to provide information on the response to the crisis by the international community, concerned governments, non-government organisations, and civil society at large. The third is to monitor and contribute to ongoing discussions of policy reform in response to the crisis.

I now consider the role that the ADB says it would be willing to play in regional economic monitoring and surveillance. There are three key elements.

First, the ADB would be willing to play a greater role in examining key aspects of policy reform in the region. It would be willing, for example, to manage a regional arrangement to coordinate financial sector reform in East Asia, such as an East Asian Banking Advisory Committee or an Asian Financial Institute.

Second, the ADB would be keen to extend its technical support for regional surveillance beyond ASEAN to the ASEAN+3 – a process that is already under way.

Finally, as East Asia extends and deepens its cooperative financing arrangements, the ADB would like to play a formal role in these regional financial arrangements. In particular, it volunteers to manage the pooling of regional foreign exchange reserves, including the disbursement of those reserves and the identification and enforcement of associated conditionalities for lending.

SOME ISSUES

Having looked at IMF and ADB views on surveillance, especially regional surveillance in East Asia, we can see some striking similarities and differences in what they say. At the start, it is worth emphasising the similarities, because they are very important. Both institutions are firmly committed to the view that effective monitoring and surveillance of macroeconomic and financial conditions and policies is an essential element in promoting regional economic stability. Both institutions support open and substantive policy dialogue in the region. Both institutions have many high-quality staff.

The differences are less important than the similarities. The IMF and ADB have different degrees of enthusiasm about regional financial dialogue, with the IMF more guarded and the ADB a more enthusiastic supporter. These are genuinely held beliefs. But what is clear to policymakers in the region is that these institutions' beliefs also reflect their interests. The IMF is the global incumbent with a wealth of experience in surveillance and a big and unrivalled pool of intellectual talent. It is the main game and may see itself this way. The ADB is the younger institution and sees an opportunity to position itself at the core of an East Asian infrastructure. It is the only existing institution in the region that can play this role.

Both institutions have something to offer regional policy dialogue. Both institutions, however, face serious impediments in projecting their views and interests in the region.

The capabilities and resources of the IMF are widely acknowledged in East Asia, and these are the Fund's greatest asset in surveillance. The willingness of the IMF to speak independently and directly on issues is also appreciated, even if regional policymakers at times criticise it for insensitivity. But it is hamstrung. One feature of East Asian regionalism that underpins the ASEAN+3 process is a desire to find Asian solutions to Asian problems. This is itself a product of the tension that arose during the Asian financial crisis between East Asia on the one hand and the IMF (and the United States) on the other.⁶ In some quarters, the IMF is seen as part of the problem, not the solution, although this does not seem to be the majority view in East Asia. But the fact that the IMF is so clearly an outsider puts it at a disadvantage in terms of current regionalist sentiment in the region.

One example is the way in which many in the region view the approach of the IMF (and, for that matter, the United States) in MFG meetings. The MFG has been seen in the region as largely a forum for the IMF and the United States to pursue economic reform in East Asian countries, rather than a forum for genuine dialogue between countries in East Asia and North America on key macroeconomic issues of concern. Takahashi (2002: 4) is blunt about the assessment of the MFG by Japan (and others):

The Manila Framework meeting was once called the 'Asian G-7' and was expected to become an important forum for policy dialogue. However, in reality, discussion at this forum is not lively, partly because of its nature. Namely, the US (and the IMF) unilaterally preach to Asian countries.

Such dissatisfaction led to reform of the MFG in 2003 under the stewardship of South Korea. Responsibility for dialogue has been shifted more to country members and there is a greater focus on research-based discussion of issues that matter to the region, while still welcoming the active participation of the IMF.

The perception in the region is that the IMF is more interested in using regional policy dialogue forums to advance the cause of economic reform rather than facilitate dialogue, create trust and mechanisms for cooperation, and better secure economic stability and prosperity, including the pursuit of economic reform. This perception is probably a caricature of what IMF officials really want for the region. But it creates some distance between regional policymakers and the Fund because there are suspicions that the aims of the two sides are different. To some extent, this would be alleviated by greater involvement of IMF staff, especially at senior levels, in East Asian discussion and dialogue.

The ADB faces a different set of constraints. The ADB could play an important role, not just in regional dialogue, surveillance and reform processes, but also in regional cooperative financing arrangements. But the ADB is a new entrant to the business of regional monitoring and surveillance. REMU, the unit that is responsible for this job within the ADB, is small in size and other resources. A substantial enlargement of both the professional capacity and other resources devoted for regional monitoring and surveillance within the ADB would be required for the institution to effectively perform the duties of regional monitoring and surveillance.

Some in the region also have concerns that the geographic coverage of the ADB is too wide to make it the base for East Asian dialogue and cooperation. Moon et al. (2003: 15) argue that ADB assistance goes to 43 countries. They say:

... there are limits to ... [its] ability to strengthen solidarity among members. It will be very difficult to bring all these [43] countries together for regional cooperation.

The ADB is Asian (as well as Pacific), but some see it as too broad to be *East* Asian. It is more supportive of regional processes than the IMF, but its diverse responsibilities and wide membership mean that it too is seen by some as not sufficiently representing the aspirations of East Asia in financial and monetary cooperation. For an institution which is meant to service the development needs of the Asia Pacific region, there are also concerns that scarce resources are being diverted from otherwise important development projects, especially in countries outside East Asia. And because it is a development bank, its policy responsibilities do not include surveillance of the region's developed economies, notably Japan.

END NOTE

The issue of policy dialogue for monitoring and surveillance of macroeconomic and financial developments and policies is a complicated one. This chapter has looked at the issue from the perspective of the IMF and the ADB, two of the key multilateral institutions involved.

Both institutions think that effective monitoring and surveillance of macroeconomic and financial conditions are an essential element in securing economic and financial stability. Both support regional dialogue for this purpose. Where they differ is in the emphasis. The IMF cautions against regional mechanisms for their own sake; it says they need to be purposeful, substantive, and well managed. The IMF sees the development of surveillance mechanisms as a regionally-based initiative, but believes it can assist because it can bring a global perspective and experience. The ADB has been strongly supportive of regional arrangements, has helped build surveillance capacity in ASEAN and has provided information on developments in particular countries. It would like to play a bigger role.

Both institutions face constraints. The IMF has well-established credentials in surveillance, but it is seen as an outsider to the region; this limits the degree to which the region will want to involve it in regional institutions. The ADB is an Asia Pacific institution and so also has limited appeal as an institution for East Asia. As a regional development bank rather than regional monetary fund, it is not clear that it is the most appropriate vehicle to deliver regional surveillance and financial cooperation.

In the final instance, it will be up to Asia to decide how it wishes to proceed on regional surveillance. In the process, some 'competition' between the IMF and ADB is likely to be healthy and beneficial for all concerned.

NOTES

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- 1 See <<http://www.imf.org/external/np/rosc/rosc.asp>>.
- 2 For example, see de Brouwer (2003a).
- 3 The next five paragraphs draw heavily on ADB (2003).
- 4 ARIC can be accessed at <<http://aric.adb.org>> or through the ADB web site at <<http://www.adb.org>>.
- 5 The ARIC web site is designed primarily for use by government agencies, the international assistance community, private sector users, NGOs, economic policy analysts, academic researchers, and journalists. It includes seven sections: Recovery Watch, Social Dimensions, International Assistance, Country Focus, ARIC Indicators, Meetings and Conferences, and Key Hyperlinks. Under the ARIC initiative, REMU staff and consultants also prepare an Asia Recovery Report twice a year.
- 6 See de Brouwer (2003b).

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