



PACIFIC ECONOMIC PAPERS

No. 342, 2004

**A Regional Bond Market for East Asia?
The Evolving Political Dynamics of
Regional Financial Cooperation**

Jennifer A. Amyx

AUSTRALIA–JAPAN RESEARCH CENTRE
ASIA PACIFIC SCHOOL OF ECONOMICS & GOVERNMENT

PACIFIC ECONOMIC PAPER NO. 342

2004

**A Regional Bond Market for East Asia?
The Evolving Political Dynamics of
Regional Financial Cooperation**

Jennifer A. Amyx
Department of Political Science
University of Pennsylvania

AUSTRALIA–JAPAN RESEARCH CENTRE
ASIA PACIFIC SCHOOL OF ECONOMICS & GOVERNMENT

© Australia–Japan Research Centre 2004

This work is copyright. Apart from those uses which may be permitted under the *Copyright Act 1968* as amended, no part may be reproduced by any process without written permission.

Pacific Economic Papers are published under the direction of the Research Committee of the Australia–Japan Research Centre. Current members are:

Ms Jillian Broadbent Reserve Bank of Australia	Mr Jeremy Ellis Melbourne	Prof. Jocelyn Horne Macquarie University
Prof. Gordon de Brouwer The Australian National University	Mr Ted Evans Canberra	Prof. Andrew MacIntyre The Australian National University
Prof. Jenny Corbett The Australian National University	Mr Rob Ferguson Sydney	Prof. Warwick McKibbin The Australian National University
Dr Wendy Craik Earth Sanctuaries Ltd.	Dr Stephen Grenville The Australian National University	Prof. Alan Rix University of Queensland
Prof. Peter Drysdale The Australian National University	Prof. Stuart Harris The Australian National University	

Papers submitted for publication are subject to double-blind external review by two referees.

The Australia–Japan Research Centre is part of the Asia Pacific School of Economics and Government, The Australian National University, Canberra.

ISSN 0 728 8409

ISBN 0 86413 295 6

Australia–Japan Research Centre
Asia Pacific School of Economics and Government
The Australian National University, Canberra ACT 0200
Telephone: (61 2) 6125 3780; Facsimile: (61 2) 6125 0767
E-mail: ajrc@anu.edu.au; URL: <http://apseg.anu.edu.au>

The author sincerely apologizes to Paul Lejot, Douglas Arner, Liu Quiao, Mylene Chan, and Marshall Mays for an earlier version of this paper that neglected to properly acknowledge their October 2003 paper, ‘Asia’s Debt Capital Markets: Appraisal and Agenda for Policy Reform’, published by the Hong Kong Institute for Monetary Research as HKIMR Working Paper No. 19/2003.

The omission is corrected in this revised version of PEP No. 342, which is intended to replace the original. The author alone is accountable for the error.

CONTENTS

<i>List of tables</i>	iv
Introduction	1
Three cases of financial cooperation within ASEAN+3	3
Explaining variation in outcomes across initiatives	13
Challenges to the realisation of an Asian bond market	18
Conclusion	19
Acknowledgments	23
<i>Notes</i>	23
<i>References</i>	26

TABLES

Table 1	Three major areas of financial cooperation pursued in the ASEAN+3	4
Table 2	Basic elements of bilateral swaps under the Chiang Mai initiative	6
Table 3	Division of labour in working toward creation of a regional bond market	12
Table 4	Elements of bond market infrastructure and corresponding candidates for leadership within ASEAN+3	17
Table 5	Foreign currency sovereign debt short-term ratings	20
Table 6	Foreign currency sovereign debt long-term ratings	20
Table 7	Relative economic capabilities among ASEAN+3 nations, 1990–2002	22

A REGIONAL BOND MARKET FOR EAST ASIA? THE EVOLVING POLITICAL DYNAMICS OF REGIONAL FINANCIAL COOPERATION

This paper examines the evolving political dynamics of regional financial cooperation in East Asia since the 1997–98 Asian financial crisis, examining in particular the factors contributing to the growing momentum behind the recent Asian bond market initiative being pursued by the Association for Southeast Asian (ASEAN) nations plus Japan, China and South Korea (referred to collectively as ‘ASEAN+3’). The paper argues that this initiative is making rapid progress because it resonates positively with the domestic political agendas of many leaders in the region, is an initiative that numerous countries can claim at least partial ‘ownership’ of, and elicits considerable support from actors outside the region.

Introduction

Many factors have served as impetus for greater regional cooperation and integration in East Asia in recent decades. These include the desire of countries in the region to realise the benefits of deeper economic integration, the region’s reaction to the rise of regionalism in Europe and the Americas, and the belief by some that regional trade cooperation could move forward liberalisation efforts in the General Agreement on Trade and Tariffs (GATT) and the World Trade Organization (WTO), while better positioning regional actors in this process.¹ Until the 1997–98 Asian financial crisis, such cooperation was focused either in subregional forums such as the Association for South East Asian Nations (ASEAN) or in larger forums such as the Asia Pacific Economic Cooperation (APEC) forum that encompassed actors across the Asia Pacific and included the United States, as well as Australia and other Pacific Basin nations. Trade issues (and security issues, in the case of ASEAN) tended to dominate the agenda. By the mid-1990s, Asia Pacific cooperation was at its zenith in the eyes of many regional actors – and in the eyes of Japanese officials, in particular. In 1995, Japan hosted an APEC summit in Osaka; in 1996, the Japanese government generously financed the launching of the Asia Pacific Agenda Project (APAP), a consortium of policy research institutes in the Asia Pacific conducting research on how to further develop and strengthen an Asia Pacific community.

The 1997–98 financial crisis spurred two shifts in trends in regional cooperation. First, *financial* cooperation replaced trade cooperation as the priority item. In particular, the establishment of

cooperative mechanisms to prevent the recurrence of financial crisis became a key imperative. Second, the primary forum for such efforts became one comprised exclusively of *East Asian* countries. A new informal regional grouping, dubbed 'ASEAN+3', brought together the ASEAN member countries and Japan, China and South Korea. This grouping was notable not only because it included the less developed countries of Myanmar and Laos (which were left out of APEC), but also because it excluded the United States and other Pacific economies such as Australia. The group held its first summit in Kuala Lumpur in December 1997; since 1999 it has coalesced into an important independent forum for regional financial cooperation. Recently, it has shown signs of becoming the leading forum in regionalisation in East Asia as a whole.²

This paper analyses the political dynamics of regional financial cooperation within ASEAN+3, focusing in particular on the political dynamics surrounding what is widely perceived to be the group's current operational task: the establishment of a full-fledged regional bond market. This initiative represents the third major item addressed by the ASEAN+3 nations. It follows on the heels of the Chiang Mai Initiative (CMI), which involved the creation of a short-term liquidity support facility via a network of bilateral currency swaps, and comes after a period of focused attention and dialogue within the forum on issues surrounding the establishment of a common currency arrangement in the region.

The Asian bond market initiative deserves our attention for at least two reasons. First, developments related to the establishment of an Asian bond market have been much faster than progress on the first two major ASEAN+3 agenda items. A better understanding of the reasons for this should shed light on the key factors affecting regional cooperation outcomes. Second, the successful establishment of an Asian bond market has tremendous implications for actors both inside and outside the region. The initiative is inextricably linked to financial reform and liberalisation processes in all East Asian economies. It could also have a large impact on the ability of key global economies such as the United States to continue to fund their fiscal deficits.

As background to understanding the way in which the political dynamics of the regional bond market initiative differ importantly from those surrounding other initiatives, I first review the outcomes across three financial cooperation initiatives pursued within ASEAN+3 thus far. I then seek to explain the variation in results across initiatives through attention to political variables. The argument made here is threefold. First, I argue that the bond market initiative resonates more positively with the domestic political agendas of many leaders in the region. Second, I argue that this is an initiative where the capacities of many smaller actors in the region to contribute all or some leadership are much greater than a survey of aggregate economic power distribution in the region would suggest. The result is that the initiative generates region-wide enthusiasm, while dampening some of the suspicions and distrust

plaguing previous initiatives. And, third, I argue that the initiative elicits a higher degree of support from actors outside the region who are eager to benefit from its expected by-products, including financial liberalisation and reform in ASEAN+3 economies. I conclude with a discussion of the prospects and challenges that ASEAN+3 countries face in the establishment of an Asian bond market. As we will see, despite the relatively rapid establishment of a dollar-denominated Asian bond fund, numerous impediments remain to the realisation of a regional fund denominated in local currencies or the establishment of a unified regional bond market.

Three cases of financial cooperation within ASEAN+3

When funds from the International Monetary Fund (IMF) proved inadequate for quelling crisis in Thailand in July 1997, countries in the region cooperated in a Japan-led effort to assemble bilateral aid packages for Thailand while the United States sat on the sidelines. Soon thereafter, Japanese officials put forward an informal but highly publicised proposal to establish a new regional monetary fund – dubbed an ‘Asian Monetary Fund’ (AMF) – to aid countries stricken by crisis. The AMF proposal encountered a number of obstacles – including lack of support from some countries in the region such as China and outright opposition by the United States and the IMF. Japanese officials thus aborted the initiative for a new region-based multilateral monetary institution. The rapid spread of financial crisis to other nations in the region – most notably to Indonesia and South Korea – heightened regional awareness of the dangers of ‘contagion’ and the potential benefits accruing to regional collective action in the prevention and containment of financial crises. At the same time, IMF rescue packages increasingly came under criticism for the ‘one size fits all’ character of policy conditions attached to funds and for alleged inattention to distinctive circumstances in the crisis-struck East Asian nations.

By 1999, a growing sense of regional solidarity had emerged among the East Asian economies as a result of these developments and the perceived inadequacy of financial cooperation efforts in larger forums whose membership extended beyond the boundaries of East Asia.³ Accordingly, ASEAN+3 meetings became more focused in their efforts to establish mechanisms for the prevention and management of financial crisis. Major initiatives in the four years since have aimed at realising regional cooperation in three main areas: the creation of mechanisms for short-term liquidity support, the establishment of a common currency arrangement, and the creation of an Asian bond market. Outcomes to date have varied significantly across these three broad areas (Table 1). Below I provide a brief overview of developments in each of these areas before proceeding to examine possible explanations for the variance in outcomes.

Table 1 Three major areas of financial cooperation pursued in the ASEAN+3

Area	Outcome to date	Chief political impediments
Short-term liquidity support in time of crisis in the form of the Chiang Mai Initiative involving the creation of a network of bilateral currency swaps	This has been a mixed success. A \$36.5 billion network is in place after three years of negotiation, but small amounts are involved and the release of 90 per cent of funds is tied to an IMF program being in place. There has been little progress towards multilateralisation of arrangements.	Difficulty moving beyond 'surveillance' concerns to the establishment of a surveillance mechanism.
Common currency arrangement	There has been little progress, with no initiatives except a commitment to 'study' the issues.	Great diversity in the composition of an 'optimal' currency arrangement across the region; great resistance to the idea of loss of sovereignty over monetary policy.
Asian bond market	This is in progress, but rapid developments and a number of concrete steps were taken within the first two years. However, many aspects of cooperation here are supported by actions in other regional forums, especially the Executives' Meeting of East Asia and Pacific Central Banks (central banks and monetary authorities).	Question mark over private sector support; willingness of governments with highly rated sovereign bonds to pay higher financing costs en route to the realisation of long-term objectives.

Mechanism for short-term liquidity support

The CMI, announced in 2000 by ASEAN+3, constituted the first step toward monetary integration in East Asia. Since 2001, 16 bilateral currency swap arrangements (BSAs) have been negotiated among ASEAN+3 nations. As of May 2004, the size of the network stood at \$36.5 billion.⁴ Each agreement enables parties to borrow the equivalent of \$1–3 billion in foreign exchange reserves from partners. The swap arrangements are effective for 90 days, renewable for up to two years.

On the surface, this network appears to represent significant progress in regional financial cooperation. However, a number of characteristics of the current arrangements force us to assess

outcomes to date as a mixed success. Three dimensions of current arrangements make it fall far short of being a functional equivalent to the 'Asian' monetary fund that regional actors had in mind when putting forward the initiative in 2000.

First, the amounts involved under the CMI remain small and clearly inadequate for stopping speculative attacks. ASEAN+3 member countries today continue to have access to larger amounts through the IMF than they do through the CMI. For example, Thailand's bilateral swaps with China, Japan and South Korea permit the release of a total of \$7 billion. Yet in 1997, in the midst of its crisis, Thailand sought \$17.2 billion in assistance from the IMF. With such small amounts involved, it is clear that assistance via the swap arrangements would have to be supplemented by the IMF and/or additional packages of aid negotiated in an ad hoc manner at the time of crisis, just as was done to rescue Thailand in 1997. The small amounts involved in the BSAs initially appear puzzling, given the huge amounts of foreign exchange reserves held by ASEAN+3 countries as a whole (Japan and China hold the first and second largest pools of foreign exchange in the world) and given the much larger amounts available to ASEAN+3 countries through the IMF.

Second, as shown in Table 2, the release of all but 10 per cent of the funds in the BSAs is contingent on recipient countries already having an IMF program in place. This means that what is generally considered to be the most important function of currency swap arrangements – the coordination of interventions to minimise exchange rate volatility to *pre-empt* crisis – is seriously hampered. IMF programs are generally not negotiated until crisis has already hit.⁵ In any of the bilateral arrangements, 10 per cent of the total negotiated amount (a small amount to begin with) is too minuscule to enable a country to ward off a significant attack.⁶

Third, the arrangements remain bilateral rather than multilateral. The individual negotiation of the many bilateral agreements consummated thus far has been time-consuming, with each taking from six months to a year to finalise, according to a Japan Ministry of Finance (MOF) official involved in the process. In 2001, there was consensus on many principles underlying the framework of the swaps, including their modality and basic terms, but the two parties involved worked out other aspects of each bilateral contract on a case-by-case basis. A key point of contention in these negotiations was the interest rate charged on currency loaned – that is, how much premium the drawer of funds would be required to pay in addition to the market interest rate.⁷ In some cases, the formalisation of agreements was also slowed by domestic political opposition to the requirement that drawing governments provide guarantees or collateral. Multilateralisation of the swap arrangement might be expected to lower negotiating costs.

Table 2 Basic elements of bilateral swaps under the Chiang Mai Initiative

Modality	US dollar and local currencies
Maturity	90 days, renewable for up to two years
Drawing conditions	Activation linked to IMF programs but up to 10 per cent may be disbursed without linkage to IMF programs
Interest rate	Market interest rate + premium
Other	Guarantee or collateral provided by the government of the country requesting the swap.

Source: Ministry of Finance, Japan.

The mixed outcomes of the CMI thus far are not an indication that the ASEAN+3 member countries have put to rest their efforts to create an AMF. On the contrary, more countries in the region – most notably China – are receptive to the idea of a regional monetary fund today than was the case when Japan’s vice minister for international finance, Eisuke Sakakibara, initially put forth the idea in 1997.⁸ Nevertheless, concrete steps toward multilateralisation of the BSAs, increasing the amounts involved, or making these arrangements more independent from IMF assistance have been largely absent. What explains this puzzle? When push comes to shove, even a strong spirit of regional solidarity is not strong enough to motivate stronger states to sacrifice their self-interest to the extent currently required to achieve articulated goals.

The small amounts involved in the BSAs and the linkage of their activation to the IMF can be explained by the fact that the IMF maintains a crucial capacity that ASEAN+3 lacks: credible surveillance. The IMF carries out annual review and scrutiny of member country economies via Article 4 consultations, as well as less frequent assessments of financial sector vulnerability in member countries through the Financial Sector Assessment Program (FSAP). For countries such as Japan, China, South Korea and Singapore, which rank as top holders of foreign exchange in the world and whose role would undoubtedly be limited to that of donor in the case of activation of the CMI, it would be unacceptable to lend funds to countries whose operations were not under this type of regular review and scrutiny. Linking the release of funds through the CMI to the IMF essentially lowered the likelihood of potential demand for capital from their coffers and ensured that funds lent had a better chance of being repaid. In this way, the linkage does not represent support for IMF conditionality by ASEAN+3 member nations; rather, it represents the desire of these nations to avoid seeing good money go after bad. China

pushed for 100 per cent linkage, for example, even as its government officials remained critical of IMF conditionality used in the Fund's rescue packages.⁹

When the basic guidelines for the CMI were announced at the May 2001 ASEAN+3 Finance Ministers Meeting in Honolulu, member countries included in their agreement a clause stipulating review of arrangements after three years had passed, leaving room for possible revision of the linkage requirement. This review, carried out in May 2004, provided an explicit opportunity for member nations to revisit the idea of an AMF and consider ways to eliminate the current weaknesses in the CMI arrangement. Yet the joint statement by the ASEAN+3 finance ministers issued on 15 May 2004 merely affirmed agreement to 'undertake further review of the CMI to explore ways of enhancing its effectiveness' and to establish a working group to conduct this review.¹⁰ In doing so, the group's finance ministers postponed further discussion on the issue of multilateralisation, IMF linkage or fund size until the next ASEAN+3 Finance Ministers Meeting in 2005.

In recent years, a clear consensus has emerged in East Asia that an IMF or US-determined solution to financial problems in the region is insufficient; however, the ASEAN+3 group continues to lack a credible mechanism for surveillance of member countries that can lower the forces of moral hazard to a tolerable level for participating countries most likely to be donors if drawing rights are activated. Although the May 2000 Joint Ministerial Statement of the ASEAN+3 Finance Ministers emphasised the important role of surveillance in strengthening East Asian financial cooperation, little progress was made in that area until 2002, when the ASEAN+3 countries began holding a twice yearly informal deputies meeting for 'policy dialogue'.¹¹ The extent of surveillance activities undertaken through these meetings is minimal: at each meeting, officials from each nation present a report on economic developments in their respective countries and this presentation is followed by a discussion of the contents of the report, typically carried out in a question and answer format rather than through more critical types of exchange.¹² Notably, such meetings for policy dialogue now occur more frequently among ASEAN+3 countries than they do among members of other regional groupings such as APEC. Nevertheless, this type of 'policy dialogue' is clearly inadequate as a surveillance mechanism.

Importantly, any surveillance mechanism independent of the IMF must be perceived as credible – not only to ASEAN+3 member nations, but also to actors in the international markets. After all, a truly successful arrangement is one that removes incentives to launch a speculative attack in the first place. If market players lack confidence in the ability of the ASEAN+3 nations to police themselves, then the arrangements will probably be tested and activation of the swaps necessitated – an outcome that members ultimately hope to preclude. In the absence of a credible autonomous surveillance mechanism, ASEAN+3 countries have no choice but to rely heavily on the IMF. And, as one Bank of Japan (BOJ)

official noted, it is hard to imagine that any market actor would *ever* ignore assessments by the IMF in favour of assessments made through an independent ASEAN+3 surveillance mechanism.

Why has more progress not been made in boosting the region's independent surveillance capacity? At least three reasons stand out. First, however necessary, surveillance such as that carried out by the IMF in its annual Article 4 review of member countries is seen as intrusive and politically sensitive. Gaining domestic support for the conduct of separate surveillance activities by another actor is extremely difficult, in particular, for less politically open countries such as China, Indonesia and Singapore.¹³

Second, an additional surveillance mechanism would place a significant additional administrative burden on member countries. Since the IMF boosted its surveillance capacity through the launching of the FSAP in May 1999, the administrative burden of IMF surveillance alone has risen significantly for IMF member countries. The FSAP has been viewed as a positive step forward in helping assessed countries to address financial sector problems before they reach crisis proportions, but it places a heavy burden on host country regulatory authorities.¹⁴

Indecision by the ASEAN+3 nations over whether or not to formalise the present informal association and the nature of debate to date over where a secretariat might be located if the group is formalised are indicative of additional impediments that must be overcome before the current CMI arrangements could be transformed into a formal multilateral regional monetary institution. Officially, the 'plus three' today enjoy 'guest' status at ASEAN meetings, participating by invitation only. Some ASEAN member nations fear that Japan will dominate the group if the arrangements are formalised and believe that maintaining the informal character of the group enables the ASEAN nations to retain a small degree of leverage vis-à-vis the 'plus three' that it would not otherwise have. Likewise, consensus on where to locate a secretariat for the new group – if formalised – remains elusive, with Malaysia, China, South Korea, Japan and Thailand all throwing their hats in the ring.

Despite the seemingly insurmountable problems presently impeding the transformation of the CMI into something that might be regarded as an Asian monetary fund, the simple *process* of negotiating and concluding the BSAs has had a major impact on the ability of countries in the region to fend off future speculative attacks by giving rise to dense networks of communication between central bankers and finance ministers in the region – networks that did not exist at the time of the Asian financial crisis.¹⁵ Moreover, many East Asian states have negotiated bilateral agreements on a wide range of subjects, including security-oriented cooperative agreements through reliance on networks developed through the process of the CMI negotiations.¹⁶ In this sense, even while the multilateralisation of the CMI remains problematic, cooperation over the network of bilateral currency swaps should not be regarded as a total failure. The CMI is now one of a number of preventative measures in place, complementing

measures taken by individual governments to decrease the capacity of outside actors to engage successfully in currency attacks in the region.

A common currency arrangement

In 2001–02, officials in the MOF's International Bureau increasingly sought to use the cooperative framework fostered within ASEAN+3 as a stepping stone for establishing a common currency arrangement for the region.¹⁷ This aimed to contribute to the regional public good of furthering regional financial stability, but Japanese officials also saw it as a way to invigorate Japan and Japanese financial markets by advocating that such a common currency should involve a yen-centred currency basket. However, the additional motive was problematic, as there clearly was no currency arrangement optimal to all actors in the region, given the radically divergent stages of economic development and structure of trade in the region. Accordingly, some of the MOF's activities surrounding the study of common currency arrangements elicited deep suspicion about Japan's motives within the region.¹⁸ Clearly this idea was one that focused on regional integration through the prism of Japan's national interests alone rather than through the prism of greater regional collective interests. Whereas Japanese interests within the CMI largely coincided with those held by China, interests clearly differed on this issue and the shift of focus to a common currency arrangement focused on the yen was viewed as a move by Japan to assert itself as the regional hegemon.

Understandably, the MOF's efforts in this area did not go well. Although most ASEAN nations were willing to engage in study groups such as those launched in 2001 as part of the 'Kobe Research Project', endorsed by the Asia–Europe Meeting (ASEM), few actors were enthusiastic or willing to invest significant resources in this effort.¹⁹ The BOJ was likewise very lukewarm toward the idea and sceptical about its feasibility; even Japan's private sector expressed resentment when pushed to support related efforts to internationalise the yen.²⁰ The MOF's shift of focus to the currency system and its investigation of the potential for a common currency or currency basket in East Asia similarly received little attention from US authorities. This was largely because the idea is widely viewed as infeasible. American scholars tended to either ignore the issue or focus on insurmountable obstacles.²¹

Ten years ago, internationalisation of the yen had some merit for Japanese companies; a perceived benefit of minimising exchange rate risk was a key impetus for the MOF's (largely ineffective) internationalisation strategy at the time. Different motivations fuelled the MOF's pursuit of a yen-centred regional exchange rate regime in 2001–02, however. At this time, the key concern was preventing the yen from being overshadowed by the Chinese yuan once China chooses to remove its

foreign exchange restrictions.²² Such a move by China is inevitable in the near future. The concerns of Japan's MOF are not shared by other ASEAN+3 nations, however. And it is difficult to imagine countries in East Asia giving up monetary policy autonomy, as would be required under a common currency arrangement, given that so many states in the region gained national independence only relatively recently, in the aftermath of World War II.²³

The issue of a possible exchange rate mechanism for East Asia remains a topic of discussion among the ASEAN+3 finance ministers. Yet no political leader or individual country has assumed leadership on this issue since the conclusion of the Kobe Research Project. As a result, since 2003 the subject has been dealt with under the guise of a 'special research project' administered by the ASEAN Secretariat in Jakarta.

An Asian bond market

The third initiative, which today tops the regional financial cooperation agenda, is the creation of an Asian bond market. Clear progress was being made on the CMI, but in 2002 officials in Japan's MOF sensed that the momentum of bilateral negotiations was beginning to decrease, particularly given the lack of enthusiasm over efforts to pursue a common currency or currency basket in the region. MOF officials worried that something had to be done to keep the momentum of the ASEAN+3 group going. In early 2003, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) proposed the creation of an Asian bond fund; MOF officials quickly reacted by assembling senior officials and experts from the ASEAN+3 nations for an informal meeting in Tokyo on 1 March 2003. There, Japan's senior vice finance minister, Takayoshi Taniguchi, proposed the establishment of a regional market for bonds denominated in local currencies or in a basket of Asian currencies. The proposal received strong support from finance ministers and central bank governors. In June 2003, EMEAP followed up on its earlier discussions by announcing that it would invest approximately \$1 billion in dollar bonds issued by governments and quasi-governments of eight ASEAN+3 countries into an Asian Bond Fund (ABF).

The idea for the creation of a regional bond market was not new: even before the eruption of the Asian financial crisis in 1997, there had been efforts to develop an Asian bond market as an avenue for channelling Asian capital toward regional financing. In the early 1990s, for example, the Asian Development Bank issued 'dragon bonds' in Hong Kong and Singapore. However, these dollar-denominated bonds, targeted at Asian investors, failed to draw sufficient demand due to their low liquidity.

The Asian financial crisis spurred countries in the region to rethink the idea of a regional bond market. As documented by Lejot et al (2003) , short- or medium-term bonds had been issued in almost all countries in the region, and Asian borrowers were established but not prolific international issuers. Yet Japan was the only Asian country with a comprehensive market for debt securities.²⁴ In particular, Southeast Asia lacked a well-developed corporate bond market.

The rationale for broadening and deepening regional bond markets was that doing so would make countries in the region less prone to contagion from economic shocks and shifts in sentiment because they would lessen their reliance on the banking sector and improve the efficiency with which they mobilised savings.²⁵ Moreover, the capacity to sell domestic currency bonds would eliminate the currency mismatch problem that contributed to the regional crisis.

Following the Asian financial crisis, an official from the Hong Kong Monetary Authority (HKMA) proposed the idea of an Asian bond fund within APEC, seeing it as an opportunity to grow in stature as a major financial centre. The proposal elicited little enthusiasm, however, and other routes to decreasing the risk of crisis recurrence were pursued instead. The idea fared much better within EMEAP and ASEAN+3, after some progress had been achieved on the CMI.

Over the past two years, forums with different but overlapping membership have simultaneously pursued two schemes with the common aim of establishing an Asian bond market. In June 2003, EMEAP, the region's central bankers association – which includes representatives from Thailand, Indonesia, Malaysia, Singapore, the Philippines, China, Hong Kong, South Korea, Japan, Australia and New Zealand – launched the \$1 billion ABF, as discussed above. Later in the same year, the ASEAN+3 finance ministers launched the 'Asian Bond Market Initiative' (ABMI), following up on a 2002 proposal by Japan's MOF. The ABF addresses demand side challenges while the ABMI addresses supply side challenges (Table 3).

The ABF addresses demand side issues by investing \$1 billion, contributed by EMEAP members, in high-grade debt securities (government and quasi-government) in the region. In April 2004, EMEAP announced details of plans to launch a second bond fund, dubbed 'ABF-2.' The fund is to comprise two separate vehicles for investment in local-currency bonds. A parent fund, dubbed the 'Fund of Bond Funds', is to invest in bond funds in individual markets, which would in turn be invested directly in bonds. A second fund, dubbed a 'Pan-Asian Bond Index Fund', is to invest directly in the region's local-currency bonds and is intended to offer international investors a means of exposure to a broad range of local-currency debt instruments in the region's economies.²⁶ These funds would probably be structured for investment in a portfolio containing both high investment grade and non-investment grade bonds.

Table 3 Division of labour in working toward creation of a regional bond market

Task	Forum
Supply side	ASEAN+3 (Asian Bond Market Initiative) APEC
Demand side	EMEAP (ABF-1, ABF-2)

Notes: EMEAP = Executives' Meeting of East Asia-Pacific Central Banks; ABF = Asian Bond Fund.

The blended ratings of the fund would then be of investment grade and therefore would qualify as a permissible investment for most central banks.

To address the supply side, the ASEAN+3 finance ministers launched six working groups to establish the infrastructure necessary for a well-functioning regional bond market. The working groups focus on different ways to facilitate access to regional bond markets by a wider variety of issuers. In 2004, the ASEAN+3 finance ministers established the ABMI Focal Group to coordinate the activities of these six groups. To promote market transparency and facilitate the decision-making process by both issuers and investors, they also launched the AsianBondsOnline website in May 2004. This website is intended to provide the public with information about the bond markets in the region and to provide updates on the progress made by each working group under the ABMI. Capacity-building efforts have also moved forward under the ABMI. Specifically, the Japan–ASEAN Financial Technical Assistance Fund is being used to strengthen participating members' monitoring systems and capacities to compile accurate and timely data. South Korea and Malaysia have offered to provide additional technical support in this area.

These regional developments have been supplemented by individual country efforts to nurture the development of local bond markets across the region. For example, in mid-2003 Japan's Ministry of Economy, Trade and Industry (METI) announced a scheme to provide guarantees for bonds issued by Japanese companies in the rest of Asia in local currencies. In 2004, Japan's MOF announced a second scheme for guaranteeing locally denominated corporate bonds issued by Japanese companies in other Asian markets. The METI plan takes advantage of the government's trade insurance system through Nippon Export and Investment Insurance (NEXI), while the MOF plan utilises the Japan Bank for International Cooperation (JBIC).

Explaining variation in outcomes across initiatives

The relatively rapid progress on the bond market initiative can be attributed to three main factors: the way in which the establishment of a regional bond market supports domestic political interests in particular countries; the way in which this initiative harnesses the capabilities of a wider number of regional actors; and the supportive – or at least passive – response by key actors outside the region, such as the IMF and the United States.

Resonance of domestic and regional political interests

Regional moves towards establishing a bond market served domestic political interests in many countries in the region. All ASEAN+3 nations agreed that there were benefits in developing local bond markets but that actually doing so in individual nation-states was politically difficult. A well-functioning bond market typically requires changes in tax laws, credible rating agencies and many other components as part of the market infrastructure. Getting all of these things done requires a high level of policy coordination. The ideal scenario would be to foster the development of individual local markets and then expand to a regional market arrangement, but there has been a sense in the region that individual local markets are unlikely to successfully develop in the near future. The development of a regional market might, however, serve both as a means of placing pressure on domestic actors to bring local markets up to a regional standard and as a means of providing capacity building and technical assistance for local market actors. Thus, rather than follow the European route seen with the Maastricht Treaty – where individual countries were required to achieve particular standards before they could join a regional arrangement – countries in East Asia have adopted the reverse approach in the bond market initiative. In this way, cooperation to establish a regional bond market is seen by many individual political leaders as a potential and welcome driver for domestic reforms.²⁷

Government bureaucrats and central bankers in more than one ASEAN member country have confided to me that the relative success of the ABF idea to date stems largely from the political leadership taken on this initiative. Many central banks in the region were initially sceptical about moving forward with a regional initiative before the development of domestic bond markets. Nevertheless, political pressure encouraged central bank cooperation. Such political pressure was particularly effective in Thailand. Excessive *independence* of that country's central bank from other government actors was seen as one of the causes of Thailand's crisis in 1997, and relations between the Bank of Thailand and the Thai Ministry of Finance and prime minister have therefore been closer in recent years.

Thailand is also the clearest case of political commitment playing an important role in mobilising national support for the bond market initiative. In Thailand, the establishment of a regional bond market resonates with numerous domestic political objectives. One of the bond market's most ardent proponents has been the Thai Prime Minister, Thaksin Shinawatra. For Thaksin, taking the lead here helps rebut domestic criticism of his new economic model, dubbed 'Thaksinomics', as too inward looking. This model emphasises domestic-led growth in the wake of external sector volatility and relies on the use of state-owned banks rather than normal deficit financing to spread cash to fuel economic activity.²⁸ This method of economic stimulus purportedly serves to protect Thai sovereign debt from downgrading by credit rating agencies, but it also enables Thaksin to avoid selling weak banks to foreign investors at politically unacceptable prices. As a result, this policy has fuelled criticism that the prime minister has closed Thailand's doors to foreign investment. Thaksin's promotion of the regional bond initiative helps to counter this image of a closed Thailand.

In his role on the bond market initiative, Thaksin is also clearly positioning himself to emerge as the new political leader within ASEAN. Former regional leaders such as Singapore's Lee Kuan Yew and Malaysia's Mahathir bin Mohamed have now retired. Indonesia's Megawati Sukarnoputri is weak and struggling for political survival. Thaksin clearly seeks to fill the regional leadership vacuum with his proposals to make Asia strong and independent through measures such as the development of an Asian bond market.

While the link between domestic political interests and the bond market initiative is particularly strong in Thailand, it is not the only place in the region where this regional initiative attracted greater positive attention from political actors than did previous initiatives. In Japan, too, political support was more forthcoming on this initiative than on the CMI or discussions related to a common currency arrangement. Typically, issues related to regional financial cooperation attract very little – if any – involvement by Japanese politicians. The establishment of the ABF by regional central bankers came at a time when the BOJ was under pressure by numerous actors – including Japan's MOF – to change its liability structure in line with measures that would simulate inflation-targeting policies. Ironically, the ABF commitment moved the BOJ in this direction – a move it had long been resisting as part of monetary policy. BOJ officials feared that the Bank's actions would be misinterpreted as acceding to political pressure and therefore took great care to make it explicit that the commitment of these funds was not related to monetary policy (Article 33 of the BOJ Law) but was a decision made in the interests of regional financial cooperation (Article 40, section 1 of the BOJ Law).²⁹ Nevertheless, the move received the support of Finance Minister Masajuro Shiokawa because of the way in which the BOJ's contribution to the ABF would help move the bank in the direction of inflation targeting.³⁰ Political involvement on

this issue in Japan was still low compared to the level of political involvement observed in Thailand or Malaysia, but it is noteworthy that the finance minister took it upon himself to actively (rather than passively) support the measure.

In South Korea, domestic political interests resonated well with regional cooperation initiatives under former President Kim Dae-Jung. Kim was eager for his country to play a major role in regional financial cooperation, given the devastating experience of the financial crisis for Korea and strong determination not to allow it to happen again. His successor, President Roh Moo-Hyun, initially appeared much less interested in regional cooperation issues, consumed instead with impeachment proceedings and the North Korean nuclear crisis. Accordingly, the domestic political salience of regional cooperation issues in South Korea declined notably at the beginning of the Roh administration – although quasi-governmental actors such as the Korean Asset Management Corporation (KAMCO) continued to devote considerable time and energy to the bond market issue.³¹ Roh's political problems in the domestic arena eventually led him to seek a breakthrough *somewhere*, however, and he reportedly turned into a key player behind the bond market initiative launched by ASEAN+3.³²

Greater potential contribution for some smaller regional economies

The distribution of national capabilities with respect to the establishment of a regional bond market differs significantly from the distribution of overall national economic capabilities in the region. Japan and China clearly dominate in the latter, as the size of each country's GDP as a percentage of total regional GDP shows. The bond market initiative represents a regional endeavour that allows for a range of actors – including ASEAN member nations – to contribute in various ways. In this way, the Asian bond market initiative differs from previous regional initiatives such as the CMI where Japan and China represented the key 'veto players' whose leadership (Japan) and support (China) were a prerequisite to successful cooperation.

When the CMI was put forward, for example, Japan was clearly the dominant actor. Leverage or leadership capacity in CMI-related negotiations clearly rested on the size of a nation's foreign exchange reserves and Japan's reserves in 2000–01 were far in excess of the amount needed by the nation to fend off a currency crisis of its own. At this time, South Korea's foreign exchange was only sufficient to deal with its own problems. China's reserve holdings were in excess of its potential needs, but when the CMI was put forward were smaller than they are today. In this way, China has narrowed the gap with Japan and emerged as more of a critical player on this initiative in recent years. In any case, when the basic framework of CMI was under negotiation, it was clear that Japan and China, the two major economic

powers in the region, were the only two countries that would serve exclusively as providers of funds to the bilateral currency swap network. By contrast, China's contribution to the ABMI was very limited.

A well-functioning bond market requires a significant infrastructure. This infrastructure includes a credible system of governance, comprising a strong, independent regulator of securities issuance and trading, with sound rules;³³ a guaranteeing agency; credible ratings agencies; a strong legal system with well-functioning bankruptcy procedures;³⁴ coordinated and advanced payment settlement and custodial systems;³⁵ and a developed base of natural buyers of long-dated securities (such as pension funds and insurance companies)³⁶. All these dimensions are presently underdeveloped in East Asia; no economy stands out as well equipped to lead across each area. Japan is strong in some components, but Singapore, South Korea, Thailand or Malaysia may be better positioned to lead on particular dimensions of infrastructure capacity building. Table 4 suggests which countries may possess the comparative advantage in leading the region on the development of particular components of a bond market infrastructure.

While the size of Japan's domestic bond market dwarfs all others in the region, the finance needs of the nation are unusually high: the nation faces the worst public debt situation in the G-7, with its sovereign debt rated as low as the sovereign debt of Botswana. Moreover, Japan lacks comparative strengths in many areas that might be considered essential infrastructure for a well-functioning bond market. No Japanese-owned ratings agency has significant credibility inside or outside Japan, for example: Moody's and Standard & Poor's clearly dominate in the ratings of Japanese firms. Likewise, Japan only very recently – in 1998 – established a full-fledged asset management corporation to tackle its banking sector's non-performing loans.

South Korea, meanwhile, has the most capable and technically sophisticated asset management corporation in the region, KAMCO, as well as the region's most well-developed secondary debt markets. Singapore also possesses a highly sophisticated financial market and receives high marks in such areas as market transparency and fairness. Notably, China is one of the least well positioned to lead on any of the dimensions of the infrastructure-building endeavour. In these ways, the conventional measures of economic power distribution across the region are less helpful for revealing the ways in which individual countries are positioned to exercise influence on this issue of developing a regional bond market. As a top official in the MOF's International Bureau remarked, this is an area where 'success can have many parents'.³⁷

Table 4 Elements of bond market infrastructure and corresponding candidates for leadership within ASEAN+3

Infrastructure component ³⁸	Countries best positioned to lead
1. Credible system of governance with a strong, independent regulator of securities issuance and trading and sound rules	Japan has an independent regulator, but inadequate resources undermine its 'strength' and rules and regulatory arrangements are in flux; Singapore rates highly in market transparency and fairness.
2. Guaranteeing agency	Japan has the Japan Bank for International Cooperation, but will the Japanese public support this role, given recent criticism of government-backed financial institutions and the burden on the public purse from domestic credit guarantees?
3. Credible ratings agencies	Unclear; there is heavy reliance on agencies outside the region.
4. Well-developed secondary debt markets and effective asset management corporations	South Korea (Japan has only very recently begun to move in this direction).
5. Strong legal system with well-functioning bankruptcy procedures	No obvious leader. Legal systems are in flux across the region; there are many new rules but efficient utilisation is lacking.
6. Coordinated and advanced payment settlement and custodial system	Japan (and possibly Singapore).
7. Developed base of natural buyers of long-dated securities (pension funds, insurance companies, etc)	Japan but funds are currently invested in Japanese government bonds and there may be a reluctance to shift to an 'Asian bond market' in the near term.

Position of key actors outside the region

Outside the region, reactions to efforts by EMEAP and ASEAN+3 to create a regional bond market have been supportive – or at least passive. This might be contrasted to the more anxious reaction to the 1997 Japanese proposal for the creation of the AMF; to the suspicion surrounding the evolution of the network of bilateral currency swaps in 2000 (prior to the decision to require 90 per cent linkage to the IMF); and to the United States' lack of interest in the region's common currency arrangement discussions.³⁹

IMF support has been reflected in the way in which the Fund permits the region's central banks to classify amounts put into the ABF. European nations expressed support for the establishment of an Asian bond market at the Fifth (ASEM) Finance Ministers Meeting in July 2003.⁴⁰ The United States has meanwhile adopted a stance that might be described as 'passive'.

The lack of external opposition to the Asian bond market initiative reflects perceptions that the creation of a regional bond market will neither eclipse the functions of other multilateral institutions nor significantly impact on the supply and demand dynamics of other bond markets. Theoretically, the successful creation of a vibrant regional bond market could have large implications for the United States, given that Japan ranks as the largest foreign holder of Treasury securities, followed by China.⁴¹ If the Japanese and Chinese governments shift away from US Treasury bonds and into Asian bonds, therefore, the impact could be very large – particularly if US government debt continues to burgeon.⁴² In 2003, net purchases of US Treasury bonds by 10 Asian economies accounted for 60 per cent of the net increase in the supply of such paper.⁴³

The creation of an Asian bond market is unlikely to endanger demand for US Treasury bonds in the near or medium term, however. In mid-November 2003, foreign central bank holdings of US treasuries exceeded US\$1 trillion for the first time, largely because of purchases by Asian central banks.⁴⁴ In fact, between January and August 2003 – at the same time as the bond initiative was gaining momentum – Asian holdings of US debt jumped more than US\$100 billion. Many of these reserves are held to keep currency pegs in place; a real shift away from US dollar holdings (which typically take the form of US Treasury bonds) is unlikely until these currency pegs are ended, because a halt to this system would give central banks less reason to hoard US dollars.⁴⁵

Challenges to the realisation of an Asian bond market

Despite the factors cited above, the ASEAN+3 countries face significant obstacles to realisation of articulated objectives surrounding the establishment of an Asian bond market. The sheer magnitude of reforms needed to put all necessary infrastructure in place is daunting. The flip side of this challenge is, of course, that *if* the development of a regional bond market spurs the strengthening of individual regional economies along each of these dimensions, then the implications for national financial systems and industrial financing will be huge. Realistically, however, moving forward too rapidly on financial reforms will undermine the political support structures of many political administrations in the region. One need only look at Japan's struggle to carry out its 'Big Bang' financial reforms to realise this.

Moreover, there is little evidence to suggest a direct causal link between progress made thus far at the regional level and the acceleration of domestic reform measures. In other words, it is not at all clear that regional cooperation is serving as an important catalyst for domestic reforms.⁴⁶ In Thailand, for example, even as Prime Minister Thaksin proclaims the need for Asia to become financially independent and establish a bond market of its own, development of the nation's own bond market has been delayed. For example, only in late April 2004 – weeks after the government's proclaimed target date – did the Thai government lift restrictions so as to permit the issuance of baht-denominated bonds by non-residents. Even then, such issuance by non-residents remained limited to international financial institutions.⁴⁷

Another factor impeding the establishment of an Asian bond market is the lack of involvement of the private sector in moving this initiative forward. Clearly, government-led measures will prove inadequate if the private sector is not on board. While the May 2004 Joint Ministerial Statement of the ASEAN+3 Finance Ministers did note 'the importance of active involvement of the private sector in fostering the regional bond market and promoting regional economic integration', it lacked specifics on how the governments in the region plan to more actively involve the private sector.⁴⁸

Establishment of the first ABF also meant the transfer of a small portion of each country's dollar reserves to a fund that would invest in investment grade securities. Since dollar reserves are over-abundant in the region, the commitment by financial authorities was void of any formidable political battles. And few fear any significant losses, since the funds will not be put into risky investments. The issuance of bonds in local currencies, as is the intention with the second planned Asian Bond Fund, will clearly be more politically sensitive. As Tables 5 and 6 show, sovereign debt ratings in the region vary widely. Sovereign debt of the Philippines and Indonesia, for example, has junk-bond ratings. Such countries, with non-investment grade sovereign bonds, would be the clear beneficiaries of new arrangements. Higher ratings imply cheaper debt financing; it is difficult to imagine governments (or taxpayers) with highly rated sovereign bonds willingly paying higher financing costs so as to move the regional bond market forward. Yet this is what would be required if a 'basket' of sovereign bonds was the basis for issuance of a local Asian bond.

Conclusion

The 1997–98 Asian financial crisis was a defining experience for East Asia. It gave rise to a shift in the primary substantive focus of regional cooperation in East Asia – from trade to finance – as well as to a

Table 5 Foreign currency sovereign debt short-term ratings

	Moody's bond rating	S&P bond rating
Japan	P-1	A-1+
Singapore	P-1	A-1+
Thailand	P-2	A-2
South Korea	P-2	A-2
China	P-1	A-2
Philippines	NP	B
Vietnam	NP	B
Indonesia	NP	B

Notes: Ratings as of 27 February 2004; Vietnam is not a member of the Executives' Meeting of East Asia-Pacific Central Banks and is therefore not a part of the first Asian Bond Fund.

Source: Bloomberg Database.

Table 6 Foreign currency sovereign debt long-term ratings

	Moody's bond rating	S&P bond rating
Singapore	Aaa	AAA
Japan	Aa1	AA-
South Korea	A3	A-
China	A2	BBB+
Malaysia	Baa1	A-
Thailand	Baa1	BBB
Philippines	Ba2	BB
Vietnam	B1	BB-
Indonesia	B2	B

Notes: Ratings as of 27 February 2004; Vietnam is not a member of the Executives' Meeting of East Asia-Pacific Central Banks and is therefore not a part of the first Asian Bond Fund.

Source: Bloomberg Database.

shift in the primary forum for regional cooperation from ASEAN and APEC to ASEAN+3. With the initiatives surrounding an Asian bond market, EMEAP has also emerged from the shadows as a prominent player. To date, the Asian bond market issue has been characterised by greater enthusiasm and more rapid progress than other initiatives. To explain this variance in outcomes, I have highlighted

the role played by domestic politics, the distribution of issue-specific capabilities and extra-regional actors in helping this initiative to move forward relatively rapidly.

In comparing the political dynamics surrounding the creation of an Asian bond market initiative to earlier regional initiatives, this paper suggests a number of things. First, attention to the way in which the Asian bond market initiative better resonates with domestic politics compared to earlier initiatives helps illuminate the importance of political leadership in these types of regional initiatives. As Ravenhill (2001: 15) notes, even where a functional need may exist or where increasingly interdependent interests generate the rationale for collaboration, agency is required to exploit changes in this direction.

Second, the paper's findings suggest that, in trying to explain outcomes in the arena of regional cooperation, we err by focusing too much on the distribution of aggregate economic capabilities among actors in the region. The central focus of most scholarly work on the political economy of East Asia has been on the types of aggregate power dynamics reflected in Table 7. This table reveals that the relative economic clout of China and Japan has changed considerably since the beginning of the 1990s. Japan's economy remains approximately four times that of China and its per capita income nearly 30 times that of China, but in the minds of many people 13 years of economic stagnation in Japan are juxtaposed with China's rapid growth rates in recent years. The intensity of the rivalry that emerges out of such a dramatic and rapid Japanese decline against the backdrop of a similarly dramatic and rapid Chinese rise leads us naturally to investigate the role played by competitive dynamics between these two nations in regional institution building. This is not the central dynamic defining the parameters of negotiation and cooperation between actors in the region on the bond market initiative, however. Issue-specific capabilities can – and often do – differ significantly from aggregate economic capacities. The more rapid developments on the Asian bond market initiative may be viewed as arising partly because it is a task where aggregate national economic capabilities translate less directly into leadership capacity and where Japan–China tensions play a less prominent role.

Third, the paper's findings suggest that support for or opposition to regional initiatives from outside the region is important for regional cooperation outcomes. This is especially true given the security and trade ties of Asian economies to countries such as the United States. The Asian bond market initiative strikes deeply at the heart of financial reforms and liberalisation in all ASEAN+3 member countries; as a result, it has elicited active support from many external actors.

Financial cooperation within East Asia has clearly moved beyond the embryonic stage. Tangible and intangible results alike are increasingly visible and suggest that countries in the region are highly cognisant of the potential gains from cooperating with those within their geographical proximity. Even so, there are still numerous political impediments to the full realisation of objectives articulated in both the Chiang Mai and ABF initiatives. In many respects, the easy work on these initiatives has been done.

Table 7 Relative economic capabilities among ASEAN+3 nations, 1990–2002 (per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Cambodia	0.028	0.036	0.040	0.044	0.043	0.047	0.051	0.053	0.055	0.054	0.052	0.059	0.063
China	8.880	8.301	8.419	7.667	8.600	9.776	12.082	14.092	16.696	15.491	15.724	18.608	19.980
Indonesia	2.865	2.825	2.801	2.806	2.804	2.832	3.364	3.385	1.684	2.188	2.185	2.236	2.729
Japan	76.446	76.895	76.678	77.677	76.283	74.323	69.641	67.820	69.626	69.841	69.312	66.087	63.022
South Korea	6.325	6.507	6.336	6.139	6.380	6.856	7.698	7.475	5.594	6.345	6.715	6.762	7.523
Laos	0.022	0.023	0.023	0.024	0.024	0.025	0.028	0.027	0.023	0.023	0.025	0.028	0.027
Malaysia	1.102	1.083	1.191	1.188	1.181	1.245	1.492	1.571	1.274	1.237	1.312	1.392	1.498
Philippines	1.120	1.001	1.067	0.965	1.016	1.039	1.226	1.292	1.145	1.190	1.104	1.140	1.230
Singapore	0.924	0.952	1.004	1.036	1.119	1.176	1.365	1.496	1.445	1.272	1.331	1.343	1.373
Thailand	2.137	2.165	2.244	2.220	2.291	2.353	2.689	2.367	1.974	1.912	1.786	1.829	2.003
Vietnam	0.162	0.212	0.199	0.234	0.258	0.291	0.365	0.421	0.480	0.448	0.454	0.517	0.554

Notes: Data for Brunei and Myanmar are not available so the GDPs of these countries are omitted from the total for the ASEAN+3. Economic capability is measured as country GDP (current US\$) as a percentage of the total regional GDP (current US\$) in a given year. Computations are based on World Bank data (WDI Online); data for individual countries is rounded and therefore each column may not add up to zero.

Taking them to the next step will require greater political leadership and inevitably involve a number of political battles. These political battles are likely to occur more often in the context of domestic politics rather than through intra-state conflict, however, because higher levels of commitment by individual states to an Asian bond market will require domestic political approval – both by the taxpaying public (for countries providing a regional public good) and by financial industry actors (whose near-term survival may be endangered by the concurrent process of financial liberalisation). In this way, developments hereafter will serve as a test for whether the recognition of benefits to regional cooperation in East Asia yet extends beyond financial authorities to individual citizens and private sector entities.

Acknowledgments

This paper benefited from feedback received at presentations at the National University of Singapore in January 2004 and at The Australian National University in March 2004. I am particularly grateful to Gordon de Brouwer and Atsushi Takeuchi for helpful comments. Thanks also to Erin Douglas for research assistance. Portions of this paper draw on the following article by the author: ‘Political Dynamics of Regional Financial Cooperation’, *The Japanese Economy*, 32 (2), Summer 2004.

Notes

- 1 de Brouwer (2003a, 2003b)
- 2 Regional trade cooperation at present centres on the negotiation of bilateral free trade agreements but these often transcend regional boundaries; an exclusively East Asian regional approach to trade cooperation has not yet developed, although overtures in the direction have been made.
- 3 For example, the Manila Framework Group (MFG) – whose membership encompassed the Asia Pacific – was initially established to consider the development of financial crisis prevention and management mechanisms but produced few tangible results.
- 4 Joint ministerial statement of ASEAN+3 finance ministers, May 2004, Jeju, South Korea.
- 5 As one central banker in Southeast Asia commented, ‘By the time an IMF program is established, a country has already collapsed!’ Author interview, 11 June 2002.
- 6 For a detailed analysis of the negotiations that resulted in this 90 per cent linkage and the various positions adopted by individual countries, see Amyx (2002, 2003).
- 7 Author interview with official in the International Bureau of Japan’s MOF, March 2003.
- 8 That proposal spurred a negative reaction from many countries largely because it lacked specific details and because Japan’s MOF had not undertaken appropriate consultations with the financial authorities of some of the other key countries in the region, such as China. Still, it was clear that the sentiment behind it was to offer an additional independent source of funds from

- within the region to allow respective countries to engage in an institutionalised means of self-help rather than being totally reliant on the IMF.
- 9 In an interview with the author in 2002, a Bank of Japan (BOJ) official noted that sentiment was similar within the BOJ.
- 10 Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting (15 May 2004; Jeju, Korea), accessed at <http://www.mof.go.jp/english/if/as3_040515e.htm>.
- 11 The term ‘policy dialogue’ is reportedly preferred by China and some other ASEAN+3 member countries to the more police-like term of ‘surveillance’ (author interview with MOF official, March 2003).
- 12 Author interview with MOF official, March 2003.
- 13 Author interviews with MOF officials, 2002–03.
- 14 According to an author interview with a Japan Financial Services Agency official in September 2001, the assessment essentially requires host country regulators to halt their normal activities for approximately a two-week period, translate all laws and documents into English, and engage in intense discussion and debate with IMF assessors in English concerning their findings. The reluctance of Japan’s Financial Services Agency to accede in September 2001 to an IMF request for such an assessment was motivated largely by the disruptive nature of this assessment – particularly since the request came just as regulators were struggling to deal with a string of failures of financial cooperatives.
- 15 In an interview with the author in 1999, Japan’s former Vice Minister for International Finance, Eisuke Sakakibara, noted that before the crisis he regularly communicated with individuals at the US Treasury concerning yen–dollar movements and could easily pick up the phone and call the US Treasury Secretary. Yet the same kinds of constant contact, personal familiarity and flow of information were absent in relations between Japanese officials and central bankers/finance ministers in other countries in East Asia. In interviews with the author in 1999–2002, numerous central bankers and finance ministry officials throughout the region emphasised the important role that the simple strengthening of communication networks should have in fending off speculative attacks in the future and coordinating responses.
- 16 Kim (2004: 38), for example, cites long-term security-oriented agreements signed between China and the nations of Thailand, Indonesia, Malaysia and Vietnam.
- 17 Author interviews with individuals involved in second-track dialogue within ASEAN+3.
- 18 Author interview with academics participating in a second-track conference on regional financial cooperation convened by ASEAN+3, July 2002.
- 19 Six studies were conducted under the Kobe Research Project, involving collaboration between scholars and officials from Asia and Europe, and the findings reported at an ASEM meeting in July 2002. The Asian Development Bank also actively participated in the research.
- 20 Author interview with BOJ officials, March 2003.
- 21 Japan’s own central bank has also maintained a noticeably passive position on the issue. Were such an arrangement to be realised, however, a currency basket system would have important implications for a variety of actors. For example, many Asian governments and private investors in Asia purchase US Treasury bonds. China and Japan are particularly large holders of US government securities. With a currency basket, the dollar would become less important. However, the United States has a trade deficit with Asia, so it should theoretically be interested in the issue.

- 22 Author interview with Bank of Japan officials, November 2002.
- 23 For example, the Philippines gained independence in 1946, South Korea in 1948, Indonesia in 1949, Malaysia in 1957 and Singapore in 1963.
- 24 Lejot et al (2003: 1).
- 25 Lejot et al (2003: 2), summarizing the dominant view of bond market advocates including Crockett (2002), Dalla & Chintakananda (2003), eichengreen (1999), Ghon Rhee (2000), Harwood (2002), Herring & Chatusripital (2000), Yoshitomi & Shirai (2001).
- 26 See 'East Asia: Central banks note progress in bond fund', Oxford Analytica, 15 April 2004.
- 27 Author interview with Bank of Thailand officials, 2003.
- 28 For a critical analysis of 'Thaksinomics', see 'Thaksinomics: Part II' by Nor Zahidi Alias, *Malaysian Business*, 3 November 2003.
- 29 Author interview with senior Bank of Japan officials in 2003 and 2004.
- 30 As a former MOF official, Shiokawa's familiarisation with financial issues probably also contributed to his greater interest in and support of the bond fund.
- 31 In this way, the importance of political leadership in regional cooperative endeavours may vary, depending on the stage of policy formulation and implementation.
- 32 Author interview with top MOF official in the International Bureau, 28 June 2004.
- 33 Lejot et al (2003: 18), citing a key prerequisite for the development of effective debt capital markets given by Standard & Poor's Corporation (2003).
- 34 Ibid.
- 35 Ibid.
- 36 Ibid.
- 37 Author interview with MOF official in the International Bureau, 28 June 2004.
- 38 Numbers 1, 5, 6, and 7 are from Lejot et al (2003), citing key prerequisites for the development of effective debt capital markets given in Standard & Poor's Corporation (2003). The remainder are conditions that were emphasized by interviewees in their conversations with the author (2-03-2004, Tokyo) as well as in numerous published works.
- 39 This lack of interest reflected disbelief in the feasibility of such arrangements and the sense that views in the region are so divergent as to prevent any type of progress here.
- 40 'Proposed Asia Bond Market Receives Boost from Europe', *Bernama News Agency (Malaysia)*, 6 July 2003.
- 41 January 2004 US Treasury data. The United Kingdom is the third largest foreign holder of US securities.
- 42 Notably, while amounts of US Treasury bonds held in Asia today exceed the holdings of any other region, this represents a contrast from the mid-1980s. In 1985, Japan was the largest foreign holder of US Treasury bonds but the Middle East was the largest regional holder.
- 43 'East Asia: Bond market initiative gains momentum', *Oxford Analytica, Daily Brief*, 3 March 2004.

- 44 'Thaksin on course to lead Thailand to greater heights', *New Strait Times*, 7 January 2004: B21.
- 45 Currencies officially pegged to the US dollar include the Chinese yuan, the Hong Kong dollar and the Malaysian ringgit. The Japanese government also makes interventions in the foreign exchange market with a particular dollar–yen level in mind and spent a record ¥17.8 trillion from January 2003 through 26 November 2003 to prevent the currency from appreciating 'excessively'.
- 46 It is notable that the May 2004 Joint Ministerial Statement of the ASEAN+3 Finance Ministers welcomed 'members' efforts in modifying existing regulations to facilitate the issuance of and investment in local currency denominated bonds under the ABMI' (*italics added*) – rather than acknowledging members' progress.
- 47 Hisatsugu Nagao, 'Thailand's Asia bond bid faces uphill battle', *Nikkei Net Interactive*, 24 May 2004, accessed on 24 May 2004 at <<http://www.nni.nikkei.co.jp/AC/TNW/Search/Nni20040524AP3BONDS.htm>>.
- 48 Joint Ministerial Statement of the ASEAN+3 Finance Ministers, May 2004, Jeju, Korea.

References

- Amyx, Jennifer (2002) 'Moving beyond bilateralism? Japan and the Asian Monetary Fund', *Pacific Economic Paper* No. 331, Australia–Japan Research Centre, Australia National University.
- Amyx, Jennifer (2003) 'Japan and the evolution of regional financial arrangements in East Asia', in Ellis Krauss and T.J. Pempel (eds), *Beyond Bilateralism: US–Japan Relations in the New Asia-Pacific*, Stanford CA: Stanford University Press.
- Amyx, Jennifer (various dates) Interviews with current and former officials at the following institutions: Bank of Japan; Bank Negara Malaysia; Bank of Thailand; Fiscal Policy Institute; Ministry of Finance, Thailand; International Monetary Fund; Ministry of Finance, Japan; Ministry of Finance and Economy, Korea; Monetary Authority of Singapore; and United States Treasury.
- de Brouwer, Gordon (2003a) Book review: C.H. Kwan, 'Yen Bloc: Toward Economic Integration in Asia', *Journal of Japanese Studies* 29(1).
- de Brouwer, Gordon (2003b) 'Finance in an East Asian community', *APEC Economies Newsletter* 7(3), Canberra: Australian National University.
- Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting (15 May 2004; Jeju, Korea), accessed at <http://www.mof.go.jp/english/if/as3_040515e.htm>.
- Kim, Samuel S. (2004) 'Northeast Asia in the local–regional–global nexus: Multiple challenges and contending explanations', in Samuel S. Kim (ed.), *The International Relations of Northeast Asia*, NY: Rowman & Littlefield Publishers, pp. 3–61.
- Lejot, Paul, Douglas Arner, Liu Qiao, Mylene Chan, and Marshall Mays (2003) "Asia's Debt Capital Markets: Appraisal and Agenda for Policy Reform" Hong Kong Institute for Monetary Research Working Paper No. 19.
- Ravenhill, John (2001) *APEC and the construction of Pacific Rim regionalism*, NY: Cambridge University Press.
- World Bank (various dates) *World Development Indicators*, WDI-on-line at <<http://www.worldbank.org/data/onlinedbs/onlinedbases.htm>>.

Previous *Pacific Economic Papers*

- 341 East Asian economic integration: China's perspective and policy
Xu Mingqi, 2003
- 340 Services trade liberalisation
Motoshige Itoh and Naoki Shimoi, 2003
- 339 The enigma of Toyota's competitive advantage: Is Denso the missing link in the academic literature?
Evelyn Anderson, 2003
- 338 An ASEAN Economic Community and ASEAN+3: How do they fit together?
Hadi Soesastro, 2003
- 337 Regional approaches to services trade and investment liberalisation
Jane Drake-Brockman, 2003
- 336 Beyond free trade agreements: 21st century choices for East Asian economic cooperation
Andrew Elek, February 2003
- 335 Trading with favourites: Free trade agreements in the Asia Pacific
Christopher Findlay, Hafifah Piei and Mari Pangestu, January 2003
- 334 WTO market access negotiations for non-agricultural products, Doha Round: Implications for East Asia
Kate Flowers and Malcolm Bosworth, December 2002
- 333 Regional economic integration in East Asia
Jane Drake-Brockman and Peter Drysdale, November 2002
- 332 Strengthening regional financial cooperation in East Asia
Haruhiko Kuroda and Masahiro Kawai, October 2002
- 331 Moving beyond bilateralism? Japan and the Asian Monetary Fund
Jennifer Amyx, September 2002
- 330 Impact of APEC trade liberalisation on Sino–Australian bilateral trade
Yu Sheng, August 2002
- 329 Intra-industry foreign direct investment and intra-industry trade in Korea
Jung-Soo Seo, Jong-Soon Kang and Deok-Ki Kim, July 2002
- 328 The effects of the euro on financial markets, activity and structure
Werner Studener, June 2002

- 327 The compatibility of capital controls and financial development: a selective survey and empirical evidence
Menzie D. Chinn, May 2002
- 326 The Basel process and regional harmonisation in Asia
Shinichi Yoshikuni, April 2002
- 325 Trends in global finance, markets and institutions: some implications for developments in the Asian region
William E. Alexander, March 2002
- 324 The IMF and East Asia
Gordon de Brouwer, February 2002
- 323 APEC and the new economy
Mari Pangestu and Sung-hoon Park, January 2002
- 322 East Asian steel projections for the 1990s revisited
Ben Garvey and Peter Drysdale, December 2001
- 321 Evidence of shifts in the determinants of the structure of Japanese manufacturing trade, 1970–95
Peter Drysdale and Ligang Song, November 2001

Annual subscription rate for twelve issues:

Individuals A\$65.00
Institutions A\$110.00

Cost for single issues:

A\$15.00
A\$10.00 (Students)

No postage required within Australia

Available from: Publications Department
Australia–Japan Research Centre
Asia Pacific School of Economics and Management
The Australian National University
Canberra ACT 0200, Australia
Facsimile: (61 2) 6125 0767
Telephone: (61 2) 6125 3780
E-mail: ajrc@anu.edu.au
URL: <http://ajrcnet.anu.edu.au/>