

# Economic Surveillance in East Asia and Prospective Issues

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East Asia started economic surveillance (EPRD: Economic Review and Policy Dialogue) as a region under the ASEAN+3 framework after the Asian crisis. As the economic integration proceeds further, the issue of a regional monetary system (exchange rate coordination) will be put on the political agenda. Such a system will require a strong, effective surveillance that serves not only crisis prevention but policy coordination among countries involved. The present EPRD, which complements the surveillance undertaking by the IMF, needs to be reviewed fundamentally sooner or later. The key issue will be the establishment of independent surveillance in the region with a dedicated secretariat, involving central banks more closely, and supported by reliable statistical infrastructure.

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## Introduction

Until the Asian currency crisis, the only economic surveillance conducted in East Asian countries was annual country consultations carried out by the International Monetary Fund (IMF) (the Article IV consultation)<sup>1)</sup>. The primary objective of the IMF surveillance is to ensure the economic and financial stability of member countries and the world, i.e. the prevention of a crisis. When a crisis breaks out, the IMF draws up a financial support program for a crisis-hit country and provides it with emergency financing.

Despite the IMF surveillance, however, East Asia could not stave off the currency crisis. Furthermore, because of the inappropriateness of the IMF's analysis of the causes of the crisis and the measures it took for the economies

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<sup>1)</sup> Japan, as a member state of the Organization for Economic Cooperation and Development (OECD), has undergone the OECD's annual review of its economy in addition to the IMF's surveillance.

affected, countries that accepted the IMF's support programs suffered from serious economic deterioration from 1997 through 1998, with many of their people losing jobs and forced to lower their standard of living. In other words, the IMF not only failed to make full use of surveillance in ordinary times but also erred in the diagnosis and prescriptions in emergency situations<sup>2)</sup>.

Learning from this experience, 10 member countries of the Association of Southeast Asian Nations (ASEAN), Japan, China and South Korea (ASEAN+3) began financial cooperation that focused on the prevention and resolution of a currency crisis. At the core of financial cooperation are the Chiang Mai Initiative and the launch of regional surveillance, which are to complement the IMF's mechanism for global financial stability. More specifically, if East Asia is faced with a currency crisis again, the current framework of ASEAN+3 provides only limited capability for initial crisis intervention and the IMF will take the initiative in drawing up financial support programs.

What are problems with such a system? What form should the relationship with the IMF take if and when a regional monetary system is to be planned in East Asia in the future? This paper outlines principal economic surveillance mechanisms at work in East Asia in Section 1. In Section 2, it provides an overview of the existing IMF surveillance, in particular, the Article IV consultation process, and in Section 3 considers the significance of surveillance in East Asia and issues for the future.

## 1. Current Economic Surveillance in East Asia

Economic surveillance can be roughly broken down into those conducted by international organizations like the IMF and the Organization for Economic Cooperation and Development (OECD) on a global basis and those covering particular regions such as Europe and East Asia and their constituent countries. These forms of surveillance differ in terms of their objectives and priorities, and regional surveillance varies in its specific makeup depending on the level of integration of regional economies. It can be argued that East Asia had virtually no regional surveillance until the Asian currency crisis. After the crisis, several surveillance mechanisms are now being developed. Given its relatively short history, however, the region has yet to reach the stage of full-fledged efforts toward economic surveillance.

### 1.1. ASEAN Surveillance Process (ASP)

In October 1998, when the smoke from the Asian currency crisis had not yet fully dissipated, the ASEAN Finance Ministers' Meeting (AFMM) agreed to establish the ASEAN Surveillance Process (ASP). ASEAN has defined the ASP's objectives as follows<sup>3)</sup>.

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<sup>2)</sup> For the Asian currency crisis and the IMF's response, see Tetsuji Murase, "A Zone of Asian Monetary Stability", Chapter 6 "The Asian Currency and Economic Crisis and Its Background."

- (i) Exchanging information and discussing economic and financial developments of the member states in the region;
- (ii) Providing an early warning system and a peer review process to enhance macroeconomic stability and the financial system in the region;
- (iii) Highlighting possible policy options and encouraging early unilateral or collective actions to prevent a crisis; and
- (iv) Monitoring and discussing global economic and financial developments which could have implications on the region and propose possible regional and national-level actions.

All ASEAN members participate in the ASP, which complements the global surveillance exercise undertaken by the IMF. Regarding the institutional flow of information for regional surveillance, the Financial and Macroeconomic Surveillance Unit (FMSU, which comprises two economists, two junior economists and several supporting staff) set up within the ASEAN Secretariat in Jakarta prepares surveillance reports and submits them to the ASEAN Finance Deputies Meeting (AFDM). At the AFDM meeting, based on these reports, representatives of member states and the Asian Development Bank (ADB) have substantive discussions on regional and country-by-country economic and financial developments as well as policy issues. The results of deliberations at the AFDM are reported to the AFMM. The surveillance is conducted twice a year in April and December.

Traditionally, ASEAN has taken the stance of noninterference in the internal affairs of member countries. The ASP represents the first case where member states have consented to the idea of allowing comments on internal developments to be made. In that sense, the Asian crisis may be said to have provided ASEAN with an opportunity to become more open internally to policy monitoring and review (Soesastro, 2006, p. 12).

A surveillance report is prepared on the basis of basic data used in the IMF's Article IV consultation, data templates for the ASP and financial data provided by national central banks. The surveillance report consists of two parts: the ASEAN Economic and Financial Review (AEFR), an analysis of the latest economic developments in the region and member states, and the Surveillance Issues Report (SIR), which focuses on policy issues. For example, the AEFR of the surveillance report of April 2004 covered the following areas: (i) global economic outlook, (ii) economic growth of ASEAN member states and the region as a whole, (iii) financial developments, (iv) fiscal developments, (v) international balance of payments and foreign reserves, (vi) developments in external debts, (vii) restructuring of financial institutions and business corporations, (viii) foreign exchange rate developments, and (ix) stock market developments. The SIR, meanwhile, addressed risks in sustaining ASEAN's economic recovery as a common policy issue for the region, with particular emphasis on the analysis of fiscal deficits,

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<sup>3)</sup> "Terms of Understanding on the Establishment of the ASEAN Surveillance Process" Washington DC, USA, 4 October 1998, <http://www.aseansec.org/739.htm>

**Table 1** Data template examples for ASEAN surveillance process

	Description (5 founding members report every quarter, in principle, while others report every quarter, biannually or annually, sometimes exempted)
1. GDP	
By sector	Agriculture, industry, services, etc.
By expenditure	Domestic demand (consumption, investment), net exports
2. Money & finance	
Monetary survey	Net external assets, domestic credit, narrowly and broadly defined money, accounts of monetary authorities
NPL	Amount, ratio
Bank capital adequacy ratio	Goal, current ratio
Interest rate	3-month deposit rate, minimum lending rate, interbank rate
CPI	Period average, latest month
Exchange rate \$	Latest, average nominal rate, real effective rate
Exchange rate ¥	Latest, average nominal rate
3. External sector	
BoP	Detailed BoP table (Special: net inflow of short-term borrowings)
Foreign reserves	As defined by the IMF
External debt	Total, official sector, private sector (Special: short-term debt)
Debt servicing	Principal and interest payments for total, official sector, private sector
Manufactured imports	Capital goods, materials and intermediate goods, consumer goods
4. Fiscal management	Revenue, expenditure, central government surplus/deficit, public debt, sources of debt, domestic and overseas borrowings
5. Corporate sector	New FDI, asset prices, business and consumer confidence indicators
6. Social development	Labor force, unemployment rate, nominal wages, number of strikes, etc.

Source: Prepared by the author on the basis of ASEAN training materials.

restructuring of financial institutions and business corporations as well as strengthening of the banking sector, and the improvement of the investment climate for the promotion of direct investment. In parallel, the report cited policy issues member states should address individually. Major items of the data template used for the ASP are as Table 1.

ADB has been cooperating actively in the administration of the ASP from the beginning. It has provided training programs on regional economic monitoring for officials from the finance ministries and central banks of ASEAN countries as well as the ASEAN Secretariat since 2000, and has also extended technical assistance for the establishment of national surveillance units (NSUs)<sup>4)</sup> in six of the ASEAN member states. It has also been involved in the development and operation of an early warning system within the ASEAN+3 framework. It has become an established practice for ADB, which conducts an analysis of the regional economy on the basis of its own data, to explain the regional economic outlook and policy issues at AFDM and AFMM<sup>5)</sup>.

## 1.2. Framework of ASEAN+3

The framework of the ASEAN+3 Finance Ministers Meeting is shaping up as the core of various forms of regional surveillance covering East Asia. The ASEAN+3 regional financial cooperation is made up of the four pillars of the Chiang Mai Initiative (CMI), the Economic Review and Policy Dialogue (ERPD, surveillance), the Asian Bond Markets Initiative (ABMI) and the ASEAN Research Group. Of these, ERPD is viewed by some as the “weakest link” in regional financial cooperation, since not only are its specific achievements less visible than those of the three other pillars for outsiders, but it also deals with politically sensitive issues that have the potential to be seen as interfering in domestic affairs. Nevertheless, the understanding of the need for surveillance is gradually increasing among countries concerned in the region.

### 1.2.1. Economic Review and Policy Dialogue (ERPD)

Following the launch that took place with the annual general meeting of ADB held in Chiang Mai in May 2000, economic surveillance under the ASEAN+3 framework was institutionalized at the unofficial ASEAN+3 Finance Deputies Meeting (AFDM+3) in Yangon in April 2002 (Kuroda and Kawai, 2003, p.16). Known as the “Economic Review and Policy Dialogue (ERPD),” this surveillance is conducted twice a year at the AFDM+3, which is attended by the vice finance ministers and central bank deputy governors of the 13 countries in the region, and the surveillance results are reported to the ASEAN+3 Finance Ministers Meeting (AFMM+3).

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<sup>4)</sup> By 2005, NSUs were established at the finance ministries of Cambodia, Laos, Indonesia, the Philippines, Thailand and Vietnam. There are reportedly plans for the establishment of NSUs in some other ASEAN member countries as well as outside ASEAN in 2006 or later.

<sup>5)</sup> IMF also provides AFMM with background documentation (IMF, 1999, p. 29).

### 1.2.1.1. Method of Operation

The AFDM+3 takes place in April each year when the ASEAN Finance Ministers Meeting is held, and then in November in one of the so-called Plus 3 countries (Japan, China and Korea) in an unofficial and closed session for about a day and a half. The time devoted to the ERPD is limited to about half a day. Participants are representatives of the finance ministries and central banks of the 13 countries as well as representatives of the ASEAN Secretariat and ADB. Beginning with the AFDM+3 in Nara in November 2005, representatives of the IMF also started participating. From China, in addition to the Ministry of Finance and the People's Bank of China, representatives of the Hong Kong Monetary Authority also take part. When there are urgent themes to deal with, outside experts are invited to participate, such as oil specialists when the topic is the hike of crude oil prices.

The co-chairmen, chosen in rotation from the ASEAN member states and the Plus 3 countries, respectively, preside over the AFDM+3. At the outset, representatives of ADB (and the IMF), based on background documentation<sup>6)</sup>, comment on developments and prospects for the global and regional economies, risks in the region (at the AFDM+3 held in Hainan, China, in November 2004, for example, themes were high oil prices and the possible hard landing of the Chinese economy), policy challenges for economic growth, and country-specific problems. After a question-and-answer session, representatives of the international institutions leave the meeting and delegates of the 13 countries alone conduct country-by-country surveillance. Participants speak in alphabetical order, from Brunei through to Vietnam, with question-and-answer periods in between.

The information materials used for the surveillance include reports prepared by the participating countries on their own and economic statistics provided in predetermined templates. As the ERPD has no permanent secretariat, the countries serving as co-chairmen and the ASEAN Secretariat cooperate in preparing documents to be distributed at the AFDM+3. While the templates are not made public, they are estimated to be similar to statistics used in the IMF's Article IV consultation. The templates of the 10 ASEAN countries for the ASEAN Surveillance Process are likely to be also in use in the ASEAN+3 framework in order to avoid overlapping work.

The AFMM+3 takes place in May each year simultaneously with the annual general meeting of ADB following the official AFDM+3. While central bank representatives take part in the Finance Deputies Meeting, participants in the Finance Ministers Meeting are limited to finance ministers of the 13 member countries, the ASEAN Secretary-General and the President of ADB (who takes part only in discussions on specified items of business). Among a long list of agenda, some 40 minutes are dedicated to the ERPD (in the case of AFMM+3 held in Hyderabad in May 2006), with the President of ADB commenting on economic

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<sup>6)</sup> The ADB internal materials, after being edited for external release, are publicized as the "Asian Economic Monitor" series twice a year, in July and December.

developments within and outside the region, risk factors (the problem of global imbalances, rising oil prices, the impact of rising interest rates, etc.), policy responses and etc. The participating finance ministers make statements based on papers prepared in advance or on an ad hoc basis. The attendance of the ASEAN Secretary-General can be taken as demonstrating ASEAN's firm intent to sit in the driver's seat of the ASEAN+3 framework.

#### 1.2.1.2. Objective of ERPD and Moves for Its Enhancement

The fact that the ASEAN+3 economic surveillance was launched in May 2000 at the same time as the Chiang Mai Initiative (CMI) evidences its objective of preventing currency crises. Just as the CMI is designed to prevent, manage and resolve a currency crisis (the provision of short-term liquidity to supplement the IMF), should one happen, "under the current ASEAN+3 policy dialogue framework...the purpose of the mutual surveillance system is to prevent financial crises and their spread within the region" (Park, 2004, p. 8). In other words, surveillance is designed to facilitate mutual exchange of information and exert moderate peer pressure to ensure that countries in the region do not adopt policies that could again make them the target of currency speculation.

The AFMM+3 held in Honolulu in May 2001 decided to establish a study group to examine effective ways to enhance the ERPD<sup>7)</sup>, and Japan and Malaysia, as co-chairmen, worked out recommendations after holding two meetings in November 2001 and April 2002. The AFMM+3 held in Makati in August 2003 endorsed the recommendations, and agreed to set up the ASEAN+3 Finance Cooperation Fund to financially support the operation of the ERPD.

The Study Group recommended a two-phase approach to make the ERPD more efficient and effective. "In phase one, the existing arrangement for economic reviews and policy dialogue is strengthened by making the current ERPD Process more credible and subject to serious discussion by finance ministers and their deputies. In phase two, an enhanced ERPD Process will be introduced with support from an independent, professional third party that prepares reviews, assessments and issue papers on emerging problems affecting the region. It has also been proposed that the process should consider soliciting inputs from international financial institutions." (Kuroda and Kawai, 2003, p. 16).

Having achieved the initial goal with the total 16 bilateral swap agreements (BSAs) for \$36.5 billion concluded under the CMI by the end of 2003, the AFMM+3 held in Jeju in May 2004 agreed to establish a working group (co-chaired by Singapore and China) to explore ways of enhancing the CMI's effectiveness. On the basis of the review made by the working group, the AFMM+3 held in Istanbul in May 2005 set out measures to further strengthen financial cooperation in East Asia. One of the measures was the integration of the ERPD into the

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<sup>7)</sup> "The ASEAN+3 Study Group to Examine Ways of Enhancing the Effectiveness of Economic Reviews and Policy Dialogues".

CMI framework “to enable early detection of irregularities and swift remedial policy actions, with a view to developing effective regional surveillance capabilities that complement the current undertaking by the International Financial Institutions” (the Joint Ministerial Statement of the 8th AFMM+3).

Following the decision in Istanbul, the combined size of BSAs under the CMI nearly doubled to \$75.0 billion over the next year, and all swap agreements revised during this period incorporated passages linking their activation with the ERPD. The AFMM+3 held in Hyderabad in May 2006 decided to (a) establish a collective decision-making procedure for activating multiple bilateral swap agreements promptly and simultaneously during times of emergency; and (b) “to explore ways for further strengthening surveillance capacity in East Asia,” establish the Group of Experts (GOE), composed of several regional professional experts, as an independent economic assessment vehicle for this region, and also set up a working group on the development of an early warning system (the Joint Ministerial Statement of the 9th AFMM+3). Regarding (a), it is worth attention that the finance ministers from all 13 countries signed a note of confirmation concerning main principles of the collective decision-making process “to effectively and efficiently coordinate the decision making procedure of BSAs ... and to simultaneously activate relevant BSAs under the CMI framework.”

#### 1.2.1.3. Significance of the Integration of ERPD into the CMI Framework

The Group of Experts (GOE) was established on an experimental basis in order “to enable early detection of irregularities in the market and swift remedial policy actions,” also keeping in mind a two-phase approach for making the ERPD more efficient and effective (as recommended by the Study Group). The GOE points out and investigates economic and financial problems related to the region, and reports the results to the AFMM+3. As the ASEAN+3 Finance Cooperation Fund is not sufficient to fund its operations, the ASEAN+3 Regional Experts Fund was created for the GOE. When all the experts get together, the GOE meets at the ASEAN Secretariat in Jakarta.

The Technical Working Group on Economic and Financial Monitoring (ETWG), whose establishment was decided at the same time as that of the GOE, is designed to strengthen the member countries’ early warning systems, particularly by developing a quantitative monitoring model in cooperation with ADB, and to encourage cooperation in enhancing the average surveillance capacity as part of the ERPD process.

Although the key principles of the collective decision-making procedure for BSAs have not been made public, it can be assumed that a beneficiary of swap agreements is (a) required to participate in the ERPD, and (b) also required to provide economic and financial information necessary for swap providing countries to draft conditionalities. Now with the economic surveillance being an integral part of the CMI, the ERPD, which used to be simply a process for an exchange of information for peer pressure during non-emergency periods, can also be characterized as a means of ensuring *ex ante* examination (so-called *due*



diligence) for the provision of liquidity in times of emergency.

### 1.2.2. Monitoring of Capital Flows

One of the causes of the Asian currency crisis was the sudden outflow, beginning in 1997, of massive short-term capital that East Asian countries at the height of their “Miracle Growth” period had taken in US Dollars and other currencies from overseas and converted into local currencies for investment purposes, including medium- and long-term projects. Furthermore, many countries in the crisis had not carefully monitored their international positions in terms of external claims and liabilities or capital flows, which further exacerbated the crisis.

Reflecting on this mistake and keenly aware of the need to accurately and promptly follow the flows of short-term capital in particular, the ASEAN+3 countries developed from 2001 to 2004 a system designed to monitor capital flows with the support of funds from the Japan ASEAN Financial Technical Assistance Fund (JAFTA).

While balance of payments statistics are compiled monthly in accordance with the IMF manuals, the new system, with the recognition that these are not sufficient for monitoring sudden shifts in short-term capital flows, was designed to develop daily or weekly statistics for short-term capital based on reported data of foreign exchange transactions. The scope of the statistics focuses on overseas borrowings and inward non-resident portfolio investments as well as some off-balance sheet transactions, excluding relatively stable flows of foreign direct investment and

**Table 2** Scope of capital flow monitoring (Shaded Areas)

	Category	Inflow	Outflow	Collateral Information
Loans	External borrowing	Borrowings	Principal, interest	Currencies, partner countries, periods, fund sources (lender classification), purpose, etc.
	External lending	Principal, interest	Lending	
Portfolio investment	Inward non-resident investment	Acceptance	Collection	Currencies, partner countries, periods, fund sources (investor classification), etc.
	Outward resident investment	Collection	Investment	
Direct investment	Inward investment	Acceptance	Collection	Currencies, partner countries, periods, fund sources (industry classification), purposes etc.
	Outward investment	Collection	Investment	
Trade-related finance		Export proceeds	Import payments	Currencies, partner countries, industry classification, etc.
Others		Receipts	Payments	Currencies, partner countries, classification of transactions, etc.

Source: The UFJ Institute.

local capital investment overseas.

Following the process of basic research, data collection and system design and development, the capital flow monitoring systems were set up at financial supervisory authorities, commercial banks and securities custodian banks in the Philippines, Indonesia, Thailand, Vietnam, Laos, Cambodia and Brunei in a manner suited to the respective conditions of these seven countries. The capital flow monitoring systems are primarily designed to provide accurate and prompt reports on short-term capital movements for each country and to enable appropriate policy responses. Some of the ASEAN+3 countries, including Japan, exchange statistics on short-term capital flows on a voluntary basis.

### 1.2.3. Development and operation of an Early Warning System

From early on, the importance of the Early Warning System (EWS) under the ASEAN+3 framework has been recognized as an element for financial cooperation in East Asia. The Joint Ministerial Statement of the AFMM+3 held in Honolulu in May 2001 stated: "We acknowledged Korea's initiative in organizing an international seminar on early warning system modeling and joint regional monitoring in Seoul last November as part of our network of research and training institutes. We agreed to continue to exchange views on the early warning systems and to work towards developing appropriate early warning system models for East Asian countries, through appropriate processes such as holding additional seminars." In tandem with this, ADB in 2001 launched a technical assistance project for EWS development within the ASEAN+3 framework. The regional EWS model (VIEWS: Vulnerability Indicators and Early Warning System) developed by ADB was set up by 2006 at the finance ministries and central banks of the region's nine countries: Cambodia, Indonesia, Korea, Laos, Malaysia, the Philippines, China, Thailand and Vietnam.

The EWS model developed by ADB is designed to signal an approaching financial crisis. The model covers a currency crisis and a banking crisis. In the case of a currency crisis, when the monthly depreciation of a country's currency against the US dollar exceeds the sample mean (for a 24-month time horizon) by two standard deviations, the country concerned is regarded as being in a crisis (the definition of a banking crisis is omitted). The prediction of an impending crisis is one thing, but the EWS model is primarily designed to warn policymakers of the build-up of economic and financial vulnerabilities and weaknesses and allow them to respond with appropriate policies.

The currency crisis EWS model contains 41 leading indicators, two general composite indices and six sector-specific composite indices (current account, capital account, financial sector, fiscal account, real sector, and global economy). Of these, 10 leading indicators are regarded as particularly effective in providing early warning signals. When applied to the 1997 Asian crisis, it is found that the model was capable of predicting the currency crisis episode for at least four of the five crisis-hit countries of Indonesia, Korea, Malaysia, the Philippines and Thailand, with a probability of 60% or higher. Moreover, the model issued persistent

**Table 3** 10 most effective leading indicators of EWS

Currency Crisis Model (Banking Crisis Model omitted)	
1	Real exchange rate against the US Dollar*
2	Real effective exchange rate*
3	The ratio of short-term external debt to foreign reserves
4	The ratio of deposits in BIS banks to foreign reserves
5	The ratio of M2 to foreign reserves
6	The ratio of short-term capital flows to GDP**
7	The foreign liabilities/foreign assets ratio in the banking sector
8	The ratio of the current account to gross domestic investment (GDI)
9	The ratio of short-term external debt to foreign reserves**
10	The balance of real deposits at commercial banks**

\* deviation from trend, \*\* 12 month change

Source: ADB's EWS training materials.

warning signals from 20 months before the crisis for Malaysia, the Philippines and Thailand (ADB, 2005, p. 4).

Usually, there are some signs of a build up of economic and financial problems before a currency crisis breaks out. The EWS model is designed to monitor such signs for surveillance. No large-scale currency crisis has occurred since the 1997 Asian crisis, but, there was a case of a crisis limited to a single country: in August 2005, the Indonesian rupiah plunged nearly 20%, causing tension amongst policy-makers and market participants. At the time, ADB signal approach-based EWS model and the artificial nerve network (ANN) parametric-type EWS model, used by a consultancy company in Yogyakarta, both issued warning signals beforehand (sources: relevant parties).

Although various EWS models have been developed by the IMF, ADB, private banks or academics, none of these can, on their own, precisely predict a crisis. Even when warning signals are identified, some of these may simply prove to be false alarms. Many warning signals do not lead to actual currency crises, and if this is because of some policy responses taken, it is all the more desirable. The effectiveness of the EWS increases when it is used, provided its limitations are fully recognized, as part of ordinary surveillance for making comprehensive judgments in combination with specific local economic and financial conditions. Since the disproportionate emphasis on the EWS and careless handling of its data, given that the EWS is designed to detect irregular exchange rate movements in advance, could induce self-fulfilling moves in the market, specific data obtained from the EWS are not normally made public.

#### 1.2.4. Statistics

The importance of reliable and timely statistics not only for government policymakers and market participants but also for the general public cannot be overemphasized. The Asian crisis illustrated, from the standpoint of risk management, how the insufficiency or lack of statistics delayed appropriate policy responses and exacerbated the crisis. Since then, as the regional economy in East Asia has become more interdependent, the necessity of developing internationally comparable statistics is growing increasingly. Prof. Sawako Takeuchi underscores the importance of adopting common indicators in the region by pointing out that “if Asia has an organization for a cross-sectional analysis of each country’s statistics, it would provide a common ground for discussion, helping to increase mutual understanding and the early detection of problems<sup>8)</sup>.”

The Japanese government has regularly provided Asia-Pacific countries with training and technical cooperation in the area of statistics. Since the U.N. Statistical Institute for Asia and the Pacific (SIAP), an auxiliary organ of the U.N. Economic and Social Commission for Asia and the Pacific (ESCAP), was established in Tokyo in 1970, Japan, as a host country, has been contributing to its activities in terms of funding and personnel and also in kind. By the end of FY2002, Japan had accepted a total of over 8,000 trainees from ASEAN countries, China, Korea, Pakistan, Sri Lanka, Bangladesh and others<sup>9)</sup>.

The Statistics Bureau of the Ministry of Internal Affairs and Communications (MIC) has hosted the Meeting of the Heads of National Statistical Offices of East Asian Countries on 11 occasions since the first meeting in 1980 (the latest in November 2006). The Meeting is designed to draw together the heads of the central statistical organizations of the ASEAN countries, China, Korea, Mongolia and Japan “to exchange experiences in the development of various official statistics, examine the problems each country is confronting, and promote technical cooperation and mutual assistance concerning statistics<sup>10)</sup>.” The Statistics Bureau of MIC has also been undertaking statistics-related projects individually in such countries as Cambodia and Indonesia. The Ministry of Economy, Trade and Industry (METI) also regards the development of economic statistics as a key policy in its agenda and, to promote the development of statistics in ASEAN nations, it examines the international comparability of commercial and industrial statistics and sponsors training programs for the national statistical organizations of ASEAN countries. In FY2003, METI provided assistance for the development of statistics in Vietnam<sup>11)</sup>.

Under the ASEAN+3 framework, the Japanese government has sent experts to support the development of statistics in new member ASEAN countries, using

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<sup>8)</sup> Sawako Takeuchi, “Common Economic Indicators for Asia Needed,” (Ajia kyoutuuno keizaishihyou wo) The Asahi Shimbun, Opinion, May 8, 2006.

<sup>9)</sup> <http://www.stat.go.jp/index/seido/siap.htm>

<sup>10)</sup> <http://www.stat.go.jp/info/meetings/eastasia/asia10.htm>

<sup>11)</sup> [http://www.meti.go.jp/policy/statistic/main\\_01.html](http://www.meti.go.jp/policy/statistic/main_01.html)

JAFTA funds. One should keep in mind that it takes quite a long time to be able to collect one statistical data in a credible format. One of the problems confronting Japan is the fact that statistics experts are found only in a handful of institutions such as the Statistics Bureau of MIC and the Bank of Japan.

ADB has been engaged in providing bilateral and regional technical assistance for statistics in developing countries in the region in order to introduce, strengthen and improve statistics systems. The number of human resources development projects undertaken by 2006 topped more than 60 (US\$22 million or more). Priority areas for the development of statistics were national accounts in the 1970s and 1980s, national accounts, the environment, agriculture, society, population and labor statistics, finance and banks as well as the institutional enhancement of national statistical offices in the 1990s, and the Millennium Development Goals and monitoring of poverty since 2001.

In 1999, ADB implemented a project for the strengthening and collection of financial and monetary statistics because “In view of the recent financial crisis, there is an increasing need not only for accurate, timely, and relevant statistics but also for more frequently available, easily accessible and diversified statistical information. The emerging need covers additional monetary, financial and banking statistics, many of which are not presently available on a regular basis and are not traditionally covered by the activities of many statistical offices of developing member countries<sup>12)</sup>.” The central banks and financial supervisory authorities of Indonesia, Korea, Malaysia, the Philippines, Thailand, Hong Kong, Singapore, Taiwan, Bangladesh, India and Pakistan participated in the project.

### **1.3. Surveillance by Central Banks**

#### **1.3.1. Exchange of Information at EMEAP**

The Executives’ Meeting of East Asia-Pacific Central Banks (EMEAP) consists of the central banks and monetary authorities of 11 relatively advanced countries and areas: five ASEAN founding members, Japan, China, Korea, Hong Kong, Australia and New Zealand. At present, five newcomer ASEAN countries (Brunei, Cambodia, Laos, Myanmar and Vietnam) are not members. EMEAP does not have a permanent secretariat, and the Bank of Japan is acting as a private mail box for the virtual secretariat.

EMEAP’s primary objective is “to strengthen the cooperative relationship among its members<sup>13)</sup>.” EMEAP’s activities comprise three levels: Governors’ Meetings, Deputies’ Meetings and working groups. Since its establishment in 1996, EMEAP Governors’ Meetings are held twice a year for a formal session in May or June and for an informal session in November, mainly to discuss policy issues and also to exchange information on general economic developments, including GDP, price trends, interest rates and balance of payments (there are no fixed templates for economic statistics). The Governors’ Meeting of the Bank for

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<sup>12)</sup> [http://www.adb.org/Statistics/reta\\_5869.asp](http://www.adb.org/Statistics/reta_5869.asp)

<sup>13)</sup> <http://www.emeap.org>

International Settlements (BIS) is well known as a global forum for central bank governors, and heated discussions are said to be not uncommon at the bimonthly BIS meetings. In contrast, at EMEAP, discussions reportedly are held in an “Asian” amicable atmosphere with little trace of peer pressure. Apart from the twice-yearly Governors’ Meetings, the governors have frequent dialogues via a dedicated line connecting the 11 central banks using the Internet.

EMEAP Deputies’ Meetings have been in operation since 1991, ahead of the Governors’ Meetings, and form the core forum of EMEAP. Though officially held twice a year, the Deputies’ Meetings are called more frequently in practice. The Deputies’ Meetings place finishing touches on policy issues taken up at the Governors’ Meetings, closely follow rapidly changing economic and financial movements in the region, and hold discussions focusing on specific issues that emerge in the process (IIMA, 2005, p. 13). The Deputies’ Meetings also monitor discussions at working groups and determine their direction if necessary. There are three Working Groups: Financial Markets, Banking Supervision, and Payment and Settlement Systems; these provide for specialized research and an exchange of views in each area. The Asian Bond Fund (ABF) was initiated at the Working Group on Financial Markets. There is also the IT Directors’ Meeting, which is a forum for the information processing divisions of the central banks. The IT Directors exchange information on information technology and its application in the member central banks on a quarterly basis, and also hold conferences over the Internet. As central bank staff generally have long tenures in office, it is believed that close personal relationships have been fostered at EMEAP and that frank exchanges of information have been taking place among officials at equivalent levels.

### 1.3.2. SEACEN Expert Group (SEG) on Capital Flows

In 1982, the central banks of eight mostly Southeast Asian countries (Indonesia, Malaysia, Myanmar, Nepal, the Philippines, Singapore, Sri Lanka and Thailand) established the South East Asian Central Banks (SEACEN) Research and Training Centre in Kuala Lumpur. With Korea, Taiwan, Mongolia, Brunei, Fiji, Papua New Guinea, Cambodia and Vietnam joining by 2007, the number of participating central banks has now increased to 16. The Centre reviews and analyzes financial, monetary, banking and economic developments in its member countries and in the region as a whole. In recent years, it has been placing an emphasis on training relating to the policy and operational aspects of central banking<sup>14)</sup>.

As the SEACEN governors at their conference in 2000 recognized the need to manage capital flows to ensure stability in regional financial markets, the SEACEN Centre established the SEACEN Expert Group (SEG) on Capital Flows in the same year. As of 2007, the Expert Group has the participation of a total of 19 central banks—the 16 central bank members of the SEACEN Centre and the three SEACEN observers of the Reserve Bank of Australia, the Hong Kong Monetary

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<sup>14)</sup> <http://www.seacen.org/CapitalFlows/index.aspx>

Authority and the Bank of Japan. The main objectives of the Expert Group are (a) to develop a regional framework to promote information sharing on capital flows among members; and (b) to draw up concrete and practical proposals that members can implement individually or collectively to enhance the management of capital flows. In addition to the five meetings held since its establishment to 2005, the Expert Group's specific activities include (a) compilation of a directory of experts; (b) preparation of data templates on capital flows for mutual access through a database at the SEACEN Centre; (c) teleconferencing exchange to discuss issues of current interest; and (d) capacity building for the member central bank staff.

#### **1.4. Failure of the Manila Framework**

In November 1997, immediately after the abortion of the Asian Monetary Fund scheme, the United States, the IMF, Japan and others agreed to establish the Manila Framework Group (MFG or A New Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability)<sup>15</sup>. The member economies of the MFG are Australia, Brunei, Canada, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand and the United States. In addition, the chair of the Asia-Pacific Economic Cooperation (APEC) forum (then, Canada), the IMF, World Bank and ADB participated in the MFG.

The MFG, recognizing the central role of the IMF, was to take the following initiatives<sup>16</sup>:

- (a) Regional surveillance: A mechanism for regional surveillance to complement global surveillance by the IMF;
- (b) Economic and technical cooperation for strengthening financial systems: Requests for international financial institutions (IFI) to support, through technical assistance, etc., domestic authorities in their efforts to strengthen banking and financial systems and capital markets;
- (c) Measures to strengthen the IMF's capacity to respond to financial crises; and
- (d) Cooperative Financing Arrangement (CFA) for Asian monetary stability that would supplement IMF and other IFI resources: A cooperative support arrangement for Asian monetary stability under which countries provide supplemental financial resources for IMF-supported programs.

The MFG was launched as a framework of cooperation and support to replace the abandoned Asian Monetary Fund (AMF) scheme. In practice, however, the MFG was nothing more than a regional surveillance mechanism, as described in

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<sup>15</sup> Then Vice Minister of Finance for International Affairs Eisuke Sakakibara, who took part in negotiations for Japan, says: "Domestic and foreign media carried a photo showing U.S. Deputy Treasury Secretary Lawrence Summers, IMF First Deputy Managing Director Stanley Fischer and myself shaking hands, but that handshake was not so pleasant for me." (Sakakibara, 2000, p. 190).

<sup>16</sup> <http://www.mof.go.jp/english/if/if000a.htm> and <http://www.mof.go.jp/jouhou/hyouka/honsyou/14nendo/hyoukasho>

(a) above, that met twice a year with finance and central bank deputies attending. It was designed for a close exchange of views on member economies' macroeconomic policy, structural policy, exchange rate policy and financial system, etc. In reality, however, representatives of the IMF, World Bank and ADB, respectively, reported on global economic developments, structural reforms and economic developments in the Asia-Pacific region and the MFG meetings typically ended in about three hours, including question-and-answer sessions and coffee breaks. Partly because what was reported at the meetings was mostly from already published documents, "there was no new value-added" (Wang, 2002, p. 11). The MFG had no permanent secretariat of its own, and the IMF's Regional Office for Asia and the Pacific provided a logistical secretariat function for the MFG.

The IMF trumpeted the MFG as "the preeminent forum for regional surveillance and peer pressure" (Kuroda and Kawai, 2003, p. 17). "The MFG is of great significance as a forum for regular surveillance by a wide range of members. This mechanism would provide a basis for an intensive and high-level process of surveillance and dialogue among participating finance ministries and central banks with support from the IMF, World Bank, ADB and BIS" (Ministry of Finance materials). While the MFG was accorded these positive assessments by some, it was also the target of harsh criticisms, such as that it had been "largely defunct in practice" (Agarwala and Prakash, 2002, p. 25). Yunjong Wang pointed out three problems with the surveillance by the MFG: (a) the MFG failed to clearly specify the objectives; (b) there was no actual peer review process; and (c) the issues related to financial sector reform were only discussed cursorily.

The MFG reduced the frequency of meetings from twice a year to once a year in 2003, and disbanded itself at the end of 2004. The failure of the MFG can be traced to the fact that the mechanism for regional surveillance was well underway within the ASEAN+3 framework and the add-on pro forma surveillance was almost meaningless. In addition, it may be that the region's economies could not have the sense of ownership (the awareness that they are the main actors) of the MFG that was, so to speak, imposed upon them by the United States and the IMF.

## 2. Surveillance by the IMF

Compared with the ASEAN+3 surveillance, which has only a short history, the surveillance by the IMF is rendered far more weight in the international community in terms of its structure for implementing surveillance, the credibility of its content, and their impact on relevant countries and regions as well as on markets. The issue of surveillance in East Asia cannot be addressed without the IMF. This is because (1) countries in the region, as IMF members, go through the Article IV consultation process every year; (2) under the Chiang Mai Initiative, the activation of bilateral swap agreements for 80% of funds is conditional upon the IMF program; and (3) in response to the Asian currency crisis, many countries in the region, either directly or indirectly, experienced support, guidance or pressure from the IMF. Factual descriptions in this section are derived mainly from the IMF website<sup>17</sup>.



## 2.1. Role of Surveillance at the IMF

The core role of the IMF in surveillance is to promote mutual dialogue about the consequences of member countries' economic and financial policies domestically and internationally, i.e. surveillance in the sense of monitoring and consultation. A report on the external evaluation of IMF surveillance commissioned by the IMF defines surveillance as "all aspects of the Fund's analysis of, scrutiny over, and advice concerning, member countries' economic situations, policies, and prospects," and states that surveillance is conducted for the benefit both of the international community as a whole and of individual member states<sup>18</sup>. The external evaluation report cited six items as objectives of IMF surveillance: (a) policy advice; (b) policy coordination and cooperation (the IMF can contribute to policy coordination among member countries by providing neutral and reliable data, forecasts and analysis); (c) information gathering and dissemination; (d) technical assistance and aid (useful particularly for developing countries in macroeconomic policymaking); (e) identification of vulnerabilities (this role is an extension of the information provision and policy advice roles and has become much more prominent in recent years); and (f) delivering the message (the IMF provides a way by which the prevailing consensus of the economic profession is disseminated to member countries' governments and policymakers). Out of six items the most essential ones should be (a) policy advice and (c) information gathering and dissemination.

The IMF surveillance has a three-tier structure: bilateral surveillance called the Article IV consultation (details follow), regional surveillance, and multilateral surveillance concerning the global economy. Regional surveillance of monetary unions is conducted in cooperation with the relevant regional international institutions, with the coverage including the European Economic and Monetary Union, the West African Economic and Monetary Union, the Central African Economic and Monetary Community and the East Caribbean Monetary Union. The World Economic Outlook and the Global Financial Stability Report, issued semiannually by the IMF, form the core of the global multilateral surveillance, and are supplemented by unofficial papers on economic and market developments.

At summit meetings of major powers (G7/G8), the G7 finance ministers and central bank governors' meetings, or at closed-door G7 deputies' meetings, it has become established practice for the IMF to prepare and explain background documents, including reports on the current condition and prospects of the global economy and risks and policy responses.

While most of the contents of the surveillance were previously kept confiden-

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<sup>17</sup>) <http://www.imf.org>, particularly (a) A Factsheet—September 2005 "IMF Surveillance", (b) PIN No. 04/95, August 24, 2004 "IMF Executive Board Reviews the Fund's Surveillance", (c) Landmark Framework for IMF Surveillance, IMF Survey Online, June 21, 2007.

<sup>18</sup>) "External Evaluation of IMF surveillance," Report by a Group of Independent Experts, IMF, 1999, p. 17.

tial, in the wake of the Asian crisis, surveillance results have become increasingly disclosed externally with the consent of the countries concerned through the Public Information Notices (PINs). With the IMF adopting greater transparency as one of its key policies, the contents of the Article IV consultation are now made public for 80% to 90% of countries in the form of PINs and IMF staff reports, which serve as basic data for PINs.

## 2.2. Article IV Consultations

At the core of the IMF's three-tier structure of bilateral, regional and multilateral surveillance is bilateral surveillance, called Article IV consultation, conducted under Section 3 of Article IV of the IMF Articles of Agreement (Surveillance over Exchange Arrangements)<sup>19</sup>.

### 2.2.1. 1977 Decision on "Surveillance over Exchange Rate Policies"

The basic document concerning the Article IV consultation has been the 1977 Executive Board Decision on "Surveillance over Exchange Rate Policies," which was replaced by a new Decision on "Bilateral Surveillance over Members' Policies" on June 15, 2007<sup>20</sup>. The 1977 Decision, as general principles of the IMF's surveillance over exchange rate policies, (1) states that the surveillance of exchange rate policies shall be adapted to the needs of international adjustment as they develop; (2) cites a number of developments that indicate the need for discussion with a member (protracted large-scale intervention in one direction in the exchange market, etc.); and (3) describes the approach to the IMF's appraisal of a member's exchange rate policies, and also outlines procedures for surveillance. The 1977 Decision underscores the ultimate purpose of surveillance is the financial stability and sustained economic growth of member countries by quoting Section 1. of Article IV that states in part: "Recognizing ... that a principal objective [of the international monetary system] is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates."

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<sup>19</sup> Section 3. (Surveillance Over Exchange Arrangements) of Article IV (General Obligations of Members) of the Articles of Agreement of the International Monetary Fund states as follows:

- (a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.
- (b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. (The rest is omitted.)

<sup>20</sup> Selected Decisions and Selected Documents of the IMF Twenty-Ninth Issue, as updated as of June 30, 2005 [Article IV Exchange Arrangements and Surveillance "Surveillance over Exchange Rate Policies, Decision No. 5392-(77/63) as amended by Decision Nos ... 10950-(95/37, April 10, 1995), PIN No. 07/69 dated June 21, 2007 "IMF Executive Board Adopts New Decision on "Bilateral Surveillance Over Members' Policies".

### 2.2.2. Changes in the Scope of Surveillance

The objectives of surveillance emphasized by the 1977 Decision have remained intact and exchange rate policies and related macroeconomic policies (monetary and fiscal policies) also remained as central themes of the Article IV consultation for the past 30 years. However, the scope of surveillance has undergone a change and expanded in response to changes in the environment surrounding international finance, including the dramatic expansion of flows of international capital and an increasingly open world economy. Until the revision of 2007, the IMF cited the following as principal areas of surveillance, with the emphasis varying in accordance with a member country's individual circumstances (Fact sheet-September 2005<sup>21</sup>):

- (a) Exchange rate, monetary, and fiscal policies: The IMF provides advice on issues ranging from the choice of exchange rate regime to ensuring consistency between the regime and fiscal and monetary policies.
- (b) Financial sector issues: They have been receiving particularly greater emphasis under IMF surveillance in recent years. The IMF established the Financial Sector Assessment Program (FSAP) jointly with the World Bank in 1999, and is making use of its findings for surveillance.
- (c) Assessment of risks and vulnerabilities: Reflecting the growth and development of the global capital markets and the large and sometimes volatile capital flows, the scope of surveillance has been expanded beyond the traditional focus on the current account position and external debt sustainability.
- (d) Institutional issues: In the wake of financial crises and in the context of some countries' transition from planned economies to market economies, the issues related to central bank independence, financial sector regulation, corporate governance, policy transparency and accountability have gained in importance, and the IMF, jointly with the World Bank, is playing a central role in developing, implementing, and assessing internationally recognized standards and codes in these areas.
- (e) Structural issues: The need for structural reform is supported by such factors as the deceleration of growth in industrialized economies, debt crises in developing countries, and the collapse of the former Soviet Union.

### 2.2.3. Adoption of 2007 Decision on "Bilateral Surveillance over Members' Policies"

In June 2007 the IMF adopted a new Decision, which is "the first major revision in the surveillance framework in some 30 years, and it is the first-ever comprehensive policy statement on surveillance" (Managing Director Rodrigo de Rato<sup>22</sup>). The 2007 new Decision clarifies that bilateral surveillance should be focused on the IMF's core mandate, that is, promoting countries' external stability,

<sup>21</sup>) <http://www.imf.org/external/x10/changeccss/changestyle.aspx>

<sup>22</sup>) <http://www.imf.org/external/pubs/ft/survey/so/2007/POL0621B.htm>

in the newly formulated “Principles for the Guidance of the Fund” (PGF). This reflects such criticism “that the Fund curtail the expansion of the scope of surveillance into nonfinancial structural areas” (IMF, 1999, p.14).

To the “Principles for the Guidance of Member’ Policies” (PGM) that used to consist of three Principles A-C in the 1977 Decision, a new Principle D has been added (and, in addition, the meaning of exchange rate manipulation in Principle A was spelled out in an Annex).

- “A. A member shall avoid manipulating exchange rates or international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.
- B. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterized *inter alia* by disruptive short-term movements in the exchange rate of its currency.
- C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.
- D. A member should avoid exchange rate policies **that result in external instability.**”  
(bold-faced type by the author)

#### 2.2.4. Procedures for Article IV Consultation<sup>23)</sup>

The bilateral Article IV consultation between the IMF and member countries is carried out every year, in principle, with the total number of 185 member countries as of June 2007. While surveillance of smaller countries or of some countries belonging to monetary unions may be conducted only every other year, the IMF always conducts annual surveillance of major countries, including Japan and the United States, that could have a significant impact on regional economies and on the world economy (including from the regional and multilateral surveillance viewpoints). In the 1998–99 accounting year (closing at the end of April), the IMF completed Article IV consultation with 124 of the 182 member countries. From January 1, 2003 to March 4, 2004, the Executive Board of the IMF discussed 140 Article IV consultation reports (categories: 7 major advanced economies, 22 other advanced economies, 25 emerging market countries, 23 small developing island countries, 10 oil exporting countries, and 53 other developing countries)<sup>24)</sup>.

#### [Pre-surveillance internal process]

Primary responsibility for the Article IV consultation lies with the relevant area department (for example, the Asia and Pacific Department). The process of surveillance begins with the drafting of a “mission brief” by that department. The

<sup>23)</sup> The information in this subsection owes mostly to “External Evaluation of IMF Surveillance,” Report by a Group of Independent Experts, IMF, 1999, pp. 24–26.

<sup>24)</sup> IMF Biennial Review of the Implementation of the Fund’s Surveillance and the 1977 Surveillance Decision-Content of Surveillance, July 2, 2004, p. 5.

**Table 4** Chronology of an Article IV consultation (Dates are all approximate)

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Day 1: A relevant area department circulates a draft of “mission brief” to other departments concerned (functional departments, etc.)
Day 8: Final approval of “mission brief” by the Managing Director (or Deputies)
Days 15–28: IMF mission visits a member country
Day 32: A back-to-office report circulated to departments concerned and the Managing Director
Day 51: A draft staff report is circulated to departments concerned
Day 65: A staff report is circulated to members of the Executive Board
Day 90: Discussion by the Executive Board
Later: The “summing up” of discussions by the Executive Board is transmitted to the country concerned. The Public Information Notice (PIN) is published, when the country agrees.

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Source: “External Evaluation of IMF Surveillance,” IMF, 1999.

brief describes the economic situation of the country subject to surveillance and sets out the staff’s view of current policies and desirable changes, and thus serves as an outline of the major issues to be discussed in the staff report.

Functional departments such as the Research Department and the Monetary and Capital Markets Department comment on the brief, and the Policy Development and Review Department has the role of ensuring that the brief is consistent with general IMF policies, that it addresses all the topics that Article IV consultations are supposed to cover, and that it takes into account properly other departments’ comments. The brief is then sent to the Managing Director (or Deputy Managing Directors) for final approval. If there is an important issue to be discussed in the planned Article IV consultation, an ad hoc meeting of the “Surveillance Committee” is convened to review what the IMF’s approach should be. Of particular note is that the IMF’s basic stance on the country’s policies is established internally at the stage of the drafting of the mission brief, not in the staff report to be prepared after the consultation.

#### [Mission visit]

A mission usually visits a member country for about two weeks. The mission consists of at least four or five staff members, headed by a relatively senior staff member (division chief or higher) from the area department, and including some staff from functional departments as necessary<sup>25</sup>). The mission holds meetings with officials from the finance ministry, central bank, and other government ministries

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<sup>25</sup>) For example, in the Article IV consultation with China in 2004, the official mission of eight members (mainly from the Asia and Pacific Department, but also from the Fiscal Affairs Department, Monetary and Financial Systems Department and the Policy Development and Review Department) was joined by eight more members, including those stationed in the region.

involved in the formulation of economic policy with two distinct purposes of information gathering and policy discussion/advice. The mission may also have meetings with representatives of the private sector, including bankers, financial market participants, business associations, research institutions, labor union and nongovernmental organizations (NGOs). At a formal concluding meeting at the end of the mission, the mission leader makes a “concluding statement,” which summarizes the staff’s view of the country’s economy, the current policy stance, and any recommendations for changes.

Upon returning to the IMF headquarters, the mission leader submits a “back-to-office” report to the Managing Director, summarizing the most important information about the visit, and the mission staff then prepares a staff report for the Executive Board. The staff report covers the macroeconomic environment, the main economic policy issues facing the country, the staff’s forecast, and an account of the discussions between the staff and the authorities of the country. However, the most important section of the staff report is the “staff appraisal,” which sets out the staff view of the soundness of the country’s policies and possible policy changes the staff recommends. The staff report goes through the same review process as the mission brief described above.

#### [The Executive Board]

All staff reports are submitted for review to the Executive Board chaired by the Managing Director or one of the Deputies. The discussion of the staff report on a middle-sized or larger member country often occupies half a day, and most of 24 Executive Directors speak. At the end of the meeting, the Board “sums up” its views. Since the “summing up” represents the official collective view of the IMF and also forms the basis for the Public Information Notice (PIN), its first draft is prepared before the Board meeting takes place. On the basis of the Board’s discussion, the “summing up” is then finalized by the Secretary’s Department, in consultation with departments involved and the Director representing the country concerned.

The “summing up” is then transmitted to the country concerned. In cases where that country agrees, the “summing up”, together with a brief summary of the factual portion of the staff report, forms the basis for preparing the PIN for external publication. After obtaining approval of the authorities concerned, the PIN is made public (excluding market-sensitive information and factual errors, in principle).

### **2.3. Publication of Statistical Data by the IMF**

Surveillance, which forms the core of the IMF’s operations, cannot function effectively without reliable data on member countries. After becoming keenly aware of the lack/insufficiency of information, including basic economic statistics, during the currency and financial crises in the 1990s, the IMF has put particular effort into strengthening the function of the Dissemination Standard Bulletin Board (DSBB) to enhance the quality and user-friendliness of information. The DSBB is an electronic bulletin board that provides access to statistical data and

statistics preparation and dissemination practices (government statistical offices, etc.) of countries that subscribe to the IMF-prescribed data dissemination standards (actual country data can be accessed through a National Summary Data Page)<sup>26</sup>.

Given the importance of dissemination standards for internationally comparative data, the IMF has been promoting the development of reliable unified standards and urging member countries to enhance the quality of data and to improve its access. There are two kinds of data dissemination standards; the SDDS and GDDS. The Special Data Dissemination Standard (SDDS) was introduced in 1996 as a guideline for member countries that have, or that might seek, access to international capital markets. Subscription to the SDDS is voluntary, and it is designed to have members that already have a high quality of statistical data abide by the data dissemination standard (subscribers have an obligation to observe the standard). On the other hand, the General Data Dissemination System (GDDS) is a system that provides recommendations on good practice for the production and dissemination of statistics, and was put in place in 1997 for the purpose of helping member countries to provide more reliable data. The GDDS is applicable to all IMF members, but actual participants are only those countries that wish to join the system.

Countries subscribing to the SDDS are required to observe the standard regarding (a) coverage, periodicity and timeliness of the data; (b) access to the data by the public; (c) integrity of the disseminated data (including the publication of governing laws and regulations); and (d) quality of the disseminated data (including the publication of the method used in preparing statistics), and must also post actual data on the Internet site linked to the DSBB. As of July 2007, 64 countries and two organizations (the European Central Bank and the Statistical Office of the European Communities) subscribe to the SDDS; participants from East Asia include eight countries/areas—Japan, Korea, Hong Kong, Thailand, Malaysia, the Philippines, Indonesia and Singapore.

Countries subscribing to the GDDS agree to (a) committing to using the GDDS as a framework for statistical development; (b) designating a country coordinator; and (c) preparing metadata that describe (c-1) the current practices in the production and dissemination of official statistics and (c-2) plans for short- and medium-term improvements in these practices (they do not post their actual data through the DSBB). As of July 2007, 88 countries subscribe to the GDDS, with China, Brunei, Cambodia and Vietnam participating from East Asia. Laos and Myanmar have yet to participate in the GDDS.

Japan achieved the observance of the SDDS data dissemination standard in June 2000. Japan's National Summary Data Page provides access to the key items and actual figures listed below as well as to detailed items and actual figures, responsible government ministries and agencies and their web pages. The same format is

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<sup>26</sup> <http://dsbb.imf.org/Applications/web/dsbbhome>

**Table 5** Key data category and component under IMF SDDS (Japan)

	Key Data Category	Agency
1	National accounts (GDP)	Cabinet Office
2	Production index	METI
3	Labor market	Un/Employment
		Wages/earnings
4	Price indices	Consumer prices
		Producer prices
5	General government operations	Cabinet Office
6	Central government operations	MoF
7	Central government debt	MoF
8	Banking sector accounts	BoJ
9	Central bank accounts	BoJ
10	Interest rates	BoJ
11	Stock market	FSA
12	Balance of payments	MoF
13	International reserves	MoF
14	Merchandise trade	MoF
15	International investment position	MoF
16	Exchange rates	BoJ
17	External debt	MoF
18	Population	MIC

Source: <http://dsbb.imf.org/Applications/web/dsbbhome>

applicable to other countries that subscribe to the SDDS.

### 3. Significance and Prospective Issues of Surveillance in East Asia

#### 3.1. Significance of surveillance in East Asia

An anecdote has it that when an agreement was reached on the launch of surveillance under the ASEAN+3 framework in 2000, there was some controversy over the naming of the surveillance process. The 10 ASEAN countries then had the ASEAN Surveillance Process (ASP) already in place, but as an objection was voiced from the Plus 3 side that “it is a problematic proposition to inspect and police other countries’ economic situations,” they settled with naming it the Economic Review and Policy Dialogue (ERPD) instead. If you look up the word “surveillance” in a dictionary, the first meaning you get for the word is “close observation, reconnaissance, lookout” in military terms, and then “investigation, collection of data” etc<sup>27</sup>. At the time, the term “surveillance” had already been



widely accepted and used not only in ASEAN but also at the IMF, OECD and in the European Community. The anecdote above evidences how poor the understanding of surveillance was in a part of East Asia and also the fact that surveillance was regarded with a certain degree of political suspicion.

### 3.1.1. Initial Developments

At the ASEAN+3 Summit in 1999, the Korean President Kim Dae-Jung proposed and won his partners' endorsement of the establishment of the East Asia Vision Group (EAVG) of eminent persons to discuss the possibility of future cooperation in East Asia. The EAVG's report (submitted to the ASEAN+3 Summit in 2001) proposed in the area of financial cooperation (a) the establishment of a regional financing facility; (b) the launch of an official forum to exchange views on macroeconomic and financial sector policies; (c) the adoption of a more closely coordinated exchange rate mechanism consistent with both financial stability and economic development; and (d) strengthening of the regional monitoring and surveillance process within East Asia to supplement IMF global surveillance and Article IV consultation measures.

In order to review and prioritize the recommendations of the EAVG, the East Asia Study Group (EASG) of ASEAN+3 government officials was established in March 2001. It submitted its final report to the ASEAN+3 Summit held in Phnom Penh in November 2002. In terms of financial cooperation, the EASG report characterized the Chiang Mai Initiative as "an initial step toward the establishment of a regional financing." The report also stated: "The ASEAN+3 Finance Ministers Meeting has been operating as a forum for cooperation in finance. A coordinated exchange rate mechanism becomes important with the growing inter-dependence among East Asian countries that have different exchange rate systems. Policy dialogue, which is a part of regional financial cooperation, is an ongoing activity performed through the ASEAN+3 Finance Ministers Process. Efforts are also being made to strengthen coordination through a bilateral and voluntary exchange of data on short-term capital flows. **As a mechanism to be formally established in the long-term, an East Asian regional surveillance process will help enhance the financial stability in the region** (bold-faced type by the author)<sup>28)</sup>."

At around the same time as the EASG, a study group to examine effective ways to enhance the ERPD held a series of meetings based on the decision by the AFMM+3 in May 2001 (refer to Section 1.2.1.2. "Objective of ERPD and Moves for Its Enhancement"). At these meetings, the study group was divided over the concrete form of institutionalization, and agreed only on policy reviews and dialogue at an informal Deputies' Meeting, because, "At this stage of development of the CMI, many countries are not prepared to create an independent regional

<sup>27)</sup> <http://www.alc.co.jp> English-Japanese Dictionary For The General Reader, Second Edition, Kenkyusha Co., various English-English dictionaries.

<sup>28)</sup> "Final Report of the East Asia Study Group," paragraph 30, ASEAN+3 Summit, 4 November 2002, Phnom Penh, Cambodia.

**Table 6** Mechanism and features of major surveillance frameworks

	IMF (Article IV Consultation)		OECD (EDRC)	EC/EU		East Asia (ASEAN+3 CMI/ERPD)
	Ordinary surveillance	Program countries		EMS	EMU	
Information exchange	Annual mission Visit to country	Very frequent	Visit to country per 12–18 m/s	As needed	Annual country reviews	Biannual AFDM+3
Peer review/ pressure	Bilateral consultation, and Executive Board	Same as on the left	Economic and Development Review Com	Ecofin, central bank gover- nors' meeting	Ecofin, Sanc- tion under Stability and Growth Pact	AFMM+3, AFDM+3
Due diligence	—	Program conditionality	—	Medium-term credit facility	—	CMI/BSA
Surveillance objective	Stability/growth global econ- omy, member country	Recovery of external imbalances	No financing, intern'l policy coordination	Maintenance of fixed exchange rate system	Coordination of macroeco- nomic policies	Prevention of currency crises
Secretariat	Relevant area department	Same as on the left	Economic Department	European Commission	Same as on the left	None
Statistical data/others	SDDS GDDS	Officials in countries	World Econo- metric Model	Eurostat	Eurostat, BEPG	ADB, IMF

Prepared by the author.

monitoring and surveillance unit as part of the CMI" (Park, 2004, p. 9 and p. 44). Apparently reflecting this lack of consensus, the EASG put off the establishment of an official mechanism for surveillance as a long-term issue.

### 3.1.2. Significance of the ERPD

Economic surveillance consists, in general, of information gathering and exchange (monitoring), peer review and peer pressure, and due diligence (credit examination) for emergency financing. Like country reviews by the OECD's Economic and Development Review Committee, economic surveillance may be completed only with peer review and peer pressure and does not involve the provision of financial assistance. There is also an exceptional case where economic surveillance is backed up with sanction clauses against violations, such as surveillance of member states' fiscal policies in the EU's Economic and Monetary Union.

#### 3.1.2.1. Exchange of Information

An exchange of information is the weakest form of macroeconomic cooperation (Montiel, 2003, p. 6); surveillance under the ASEAN+3 framework started with a voluntary exchange of information among participating countries. Montiel cites annual G7/G8 meetings as such an example. An exchange of information includes both an explanation of economic trends with the use of statistical data and an explanation of policy intentions such as policy outlines and changes.

Even if an exchange of information is a weak form of cooperation in the pre-surveillance stage or in the initial stage of surveillance, the continuation of such

exchanges, regardless of whether these are official or unofficial, is of great significance when compared to the pre-Asian crisis period when there was no place for such exchanges of information. First, an exchange of information helps facilitate the development of statistical systems as it requires the collection of accurate and reliable national statistical data for international comparison. In East Asia, ADB established the Regional Economic Monitoring Unit (REMU: presently OREI or the Office of Regional Economic Integration) to support the ASEAN Surveillance Process (ASP) and the ERPD. Second, when policy intentions of nearby countries are known, a country can incorporate necessary adjustments into its own economic policies. More importantly, third, increased contacts between government officials and politicians contribute to the building of personal trust through contact networks.

### 3.1.2.2. Peer review and Peer Pressure

Following an exchange of information (monitoring), participating countries then move to the stage of analyzing and exchanging views on regional and country-by-country economic situations and prospects, and discussing their potential external impacts and risk factors. The scope of discussions should cover how global economic problems and risks, such as rising oil prices, will influence the regional economy and individual countries and what responses should be considered; how problems in a specific country, e.g. the possibility of financial instability or economic deceleration, will affect other countries in the region; what are the causes of such problems and what measures should be taken to contain any contagion. Politicians and officials meet and influence one another through discussion and in the form of gentle persuasion.

A good peer review is expected to have several features (IIMA, 2005, p. 5). First, as a “policy dialogue among equals,” it is a “two-way, open, frank and constructive dialogue” as opposed to a “one-way lecture.” Second, it aims at “transparency” as much as possible while the process may involve politically sensitive issues. Third, it is a “non-legally-binding” process with no coercive power in any particular sector. Fourth, it requires a high-quality secretariat. An effective peer review process requires a dedicated and specialized secretariat to conduct professional, objective and neutral analyses and assessments and to make effective, realistic policy recommendations.

ASEAN’s operational principle, traditionally called the “ASEAN way,” has been characterized by the principle of a unanimous vote and respect for national sovereignty (noninterference in internal affairs). However, the ASEAN way has been undergoing a gradual change (Soesastro, 2006, p. 10). While details about discussions at ASP-related meetings are not clear, the Surveillance Issues Report (SIR) suggests that the ASEAN process frankly points out risks and vulnerabilities for each country and recommends remedial measures.

The ERPD, meanwhile, can be considered to be in a phase of transition from an exchange of information to peer review and peer pressure. Discussion at the Finance Ministers Meeting and the Deputies Meeting consists of no more than a few questions about country presentations and is far from an atmosphere of heated

but friendly discussions among peers, partly because of the limited time allowed. However, it is important that the basis essential for a full-fledged peer review in the future, i.e. a relationship of personal trust, has been nourished over the past several years. Officials who attend the Deputies Meeting, from vice ministers to directors-general, directors and assistant directors, are said to be working in close contact at their respective levels of duties to the extent that they know when their counterparts are “getting their hair cut”. In particular, government officials from Japan, China and Korea have developed a bond of trust that was unthinkable in the past as (a) they have developed contacts for the Trilateral Finance Ministers’ Meeting, which held its seventh session in 2007; (b) they sit together to coordinate views among the Plus 3 countries ahead of the ASEAN+3 meetings; and (c) with ASEAN and the Plus 3 side acting as co-chairs for ASEAN+3 meetings because of the absence of a permanent secretariat, officials from Japan, China and Korea hold frequent working-level meetings to prepare for one of the three countries to serve as a chair.

### 3.1.2.3. Due Diligence

For an Article IV consultation of the IMF or for surveillance under the European Monetary System, regular surveillance is conducted by combining an exchange of information with a peer review to serve their respective objectives. When a member country is faced with a currency crisis or is likely to face one, as was the case of Indonesia in the Asian crisis, a financial support mechanism is activated. Regular surveillance is important in order to promptly ascertain the cause or nature (whether it is insolvency due to economic failure or a shortage of liquidity) of a currency crisis and to make an appropriate response.

In concluding an agreement for financial support, in the case of the IMF and the European Communities, the secretariat works out a detailed conditionality a debtor country should observe, in parallel with terms and conditions of loans, including amount, maturity, and interest rate. This work process is due diligence, where a lender(s), in order to secure claims, asks a borrower to submit information on (a) the current economic situation and policies; (b) the cause and background of the crisis; (c) the borrower’s economic and financing plan to cope with the crisis; (d) the short-term economic outlook; (e) foreign exchange reserves and liquidity; and (f) long- and short-term external debt balances and other data, and also receives related briefings from the fiscal and monetary authorities. A series of procedures, from the preparation of a loan agreement and due diligence to an official decision on financing, must be completed within a period of about two weeks to one month.

Should a currency crisis break out in East Asia and bilateral swap agreements (BSAs) be activated under the Chiang Mai Initiative (CMI), swap-providing countries and swap-requesting countries go through a process similar to that described above. Unlike the IMF or EC/EU, the ASEAN+3 framework lacks the permanent secretariat dedicated to surveillance. Previously, for each swap agreement, parties concerned had to hold bilateral negotiations and undertake related work. At the AFMM+3 held in Hyderabad in May 2006, an agreement was reached to adopt a

collective decision-making procedure for the activation of BSAs. More specifically, under the collective decision-making procedure, the co-chairs of the Finance Deputies Meeting serve as managers to receive requests from swap-requesting countries and call a coordination meeting consisting of the two co-chairs of AFDM+3 to ensure prompt and efficient procedures for financial support.

At the AFMM+3 in Kyoto in May 2007, an innovating decision was made that restructures the CMI into a de facto “Asian Monetary Fund.” Finance ministers “unanimously agreed in principle that a self-managed reserve pooling arrangement governed by a single contractual agreement is an appropriate form of multilateralisation. We recognized the consensus reached as a significant achievement towards an advanced framework of regional liquidity support mechanism. We instructed the Deputies to carry out further in-depth studies on the key elements of the multilateralisation of the CMI including surveillance, reserve eligibility, size of commitment, borrowing quota and activation mechanism” (the Joint Statement).

### **3.2. Prospective Issues**

Surveillance in East Asia, due in part to its short history, is still in the development stage, as exemplified by the “informal” status of the AFDM+3, a forum of substantive peer review. Future issues concerning surveillance in East Asia include surveillance objectives and a regional monetary system, the roles of central banks, the issue of the secretariat, and the relationship between surveillance in East Asia and the IMF.

#### **3.2.1. Objectives of Surveillance and a Regional Monetary System**

The Asian crisis triggered the current trend toward regional economic integration in East Asia, which takes shape in the real economy as the conclusion of free trade agreements and in the financial sector as financial cooperation under the ASAEN+3 process. Regional surveillance, which initially began on a trial-and-error basis with the objectives of prevention of a currency crisis and maintaining regional economic and financial stability, had its position clarified with the decision at the AFMM+3 in Istanbul in 2005 to integrate it into the CMI framework. Despite the irrevocable trend of regional economic integration, as long as no political consensus on the ultimate goal of regional cooperation is in sight in East Asia, surveillance inevitably remains relatively weak as with other forms of financial cooperation.

By integration into the CMI framework, surveillance has been established as a means for the prevention of a currency crisis. However, the problem is the degree how serious participating countries are concerned about the recurrence of a currency crisis, as most East Asian countries currently adopt floating exchange rate regime, i.e. there is nothing in place that can be called a regional monetary system. In the background of the Asian currency crisis was the fact that many currencies in the region were pegged to the U.S. dollar and formed a de facto regional fixed exchange rate system. Following the crisis, many countries moved to a floating exchange rate system, and the Chinese RMB and Malaysian ringgit

officially shifted in 2005 to a managed floating rate system with references to a currency basket, leaving the Hong Kong dollar and Brunei dollar with their currency board system as the only currencies in the region adopting the peg system. This tends to weaken the crisis perception, as under the floating exchange rate system currency speculations are more difficult and a currency crisis is less likely to occur.

Needless to say, even at present, there are a number of potential risks threatening the regional economic and financial stability. The risk that requires particular caution is the problem of global imbalances, as exemplified by the current account deficits and accumulating external debt of the United States, a key-currency country. While a gradual resolution of global imbalances is desirable, if the risk actualized abruptly, it would have a grave impact on the East Asian economy and disrupt the monetary and financial sectors through sharp exchange rate fluctuations. Individual economies' vulnerability to such a risk is an important issue that needs to be addressed by surveillance.

The surveillance objectives of preventing a currency crisis and ensuring economic and financial stability should gain in importance, particularly when the regional mechanism for exchange rate coordination (the East Asia Vision Group) becomes a real issue as regional economic integration progresses in the future. Like the European Monetary System in the 1980s and 90s, if currencies in the region adopt a system with a mutually fixed, but externally freely fluctuating exchange rate mechanism, such a system requires participating countries' policy coordination and credit facilities against possible currency crises. In developing the present surveillance system, one should bear in mind the possibility of establishment of a regional monetary system in future.

### 3.2.3. Roles of Central Banks

The first problem that should be cited for the current financial cooperation by central banks in East Asia (EMEAP) is the closed nature to the outside. It may have something to do with the absence of a permanent secretariat, but information about EMEAP activities is extremely scarce. In some cases, for example, central banks' websites do not even provide information about when and where official central bank governors' meetings are held, let alone their agenda.

The second problem is the relationship with the ASEAN+3 framework. While deputy governors participate in the Finance Deputies Meeting (AFDM+3), central bank governors do not attend the Finance Ministers Meeting (AFMM+3). In addition to the importance of financial cooperation per se, in some member countries, central bank governors effectively have greater voice than finance ministers. Further, with a view to the potential of a regional monetary system in the future, it is necessary to have in place an institution comprising the central bank governors of all member countries of the ASEAN+3 framework. In particular, when building and operating a future exchange rate coordination mechanism in the region, and given the precedent in Europe, fundamental judgments may be made by the finance ministers but technical matters such as market supervision,

intervention and financing facilities are likely to be left mostly to the central banks.

It appears that the five newcomer ASEAN countries' membership in EMEAP, made up of the central banks of 11 countries/areas, is not yet on the agenda, partly because their development stage is quite different from that of the existing members' economies. Given that AFDM+3 is already functioning within the ASEAN+3 framework, there is an option to add the central bank governors to AFMM+3 (the G7 formula) or to separately establish a central bank governors' meeting within the ASEAN+3 framework (the EC formula). Given that the Australian and New Zealand central banks are EMEAP members, another idea is to create an institution of central banks in the future East Asian community by adding India and the rest of ASEAN+3 members to the EMEAP lineup. At present, however, which approach to take remains uncertain.

### 3.2.3. Necessity of a Permanent Secretariat

An effective surveillance process requires a high-quality secretariat, "a very dedicated and specialized secretariat to conduct professional, objective and neutral analyses and assessments and to make effective, realistic policy recommendations." As described earlier, the East Asia Study Group put off creating a formal mechanism for surveillance as a long-term issue. Later, as countries in the region increased their understanding of the ERPD, it was integrated into the CMI process, and the AFMM+3 in 2006 decided to establish the Group of Experts (GOE) on a trial basis.

As surveillance and the credit facility (the ERPD and CMI) are operated in an integrated manner in the new reserve pooling arrangement, the existing surveillance mechanism will be confronted with its limit sooner or later. At present, the ASEAN+3 co-chairs prepare for the surveillance in rotation, supported by ADB and the ASEAN Secretariat. In addition, the GOE and the Technical Working Group on Economic and Financial Monitoring (ETWG) were established in 2006. While this loose approach that lacks continuity may be inevitable in the initial stage of developing a surveillance process in East Asia, it is obvious that there are a number of critical problems in such aspects as the accumulation of expertise and experience, objectivity and credibility of analyses, outputs and judgments, as well as mobility and reliability of operations in emergency cases.

When BSAs are activated under the CMI framework, up to 20% of the total amount can be drawn with an agreement of swap-providing countries, but the remaining 80% is conditional upon the IMF programs. In order to reduce and eventually eliminate the portion tied to the IMF and to enable flexible management of credit lines at the sole judgment of countries in the region, it is imperative to develop a viable regional surveillance system and to remove the international community's concerns about moral hazards. Since it takes time to establish a reliable system, it is advisable to start with a small-scale secretariat with highly qualified experts and government officials at its core, enhancing the system by drawing upon the precedent of the European Monetary System (roles of the Monetary Committee, the Directorate General for Economic and Financial Affairs of the European Commission, and the Council of Central Bank Governors). One

should also take into account future progress in information technology.

While there should be little objection to the necessity of a permanent secretariat in general, it is not easy to obtain a political consensus on the actual location. This is because it has the potential to grow a general secretariat for regional economic integration in the future beyond the role focused simply on surveillance. ASEAN countries are expected to support the ASEAN Secretariat in Jakarta (which has a total staff of around 200, including about five involved in surveillance) as a permanent secretariat for surveillance or else they may propose to host it in their own countries, while Japan, China and Korea have their own respective intentions. ADB's Office of Regional Economic Integration (OREI, which has some 15 staff members, as of 2006, responsible mainly for surveillance, the Asian Bond Markets Initiative, free trade agreements) and other ADB-related institutions may also emerge as candidates. The optimal requirements of candidate sites should include political and social stability, well-developed social and economic infrastructures, convenient transportation, and the attractiveness and openness to draw top-rate personnel from around the world.

#### 3.2.4. Surveillance in East Asia and the IMF

Since the 1970s, the European Community (EC) member states have never received financial assistance from the IMF for the maintenance of the Snake and the European Monetary System, and managed to ride out the European monetary crisis in 1992/93. In 1988, when two medium-term credit facilities were integrated in anticipation of the EC-wide full capital account liberalization, it was stipulated that when EC member states are introducing **external funds with conditionality**, they must consult with the EC and other member countries in advance about the possibility of utilizing regional credit facilities<sup>29</sup>). The EC's independence as seen in this particular case could be maintained because it had its own well-established surveillance and credit-providing systems.

The current situation in East Asia is quite different from the EC. East Asia accepted the IMF financial packages during the Asian crisis, and the region's post-crisis financial cooperation within the ASEAN+3 framework, i.e. the CMI and ERPD, was positioned to supplement the IMF-led international financial arrangements (provision of liquidity and surveillance). In light of the existing power balances among the region's countries, international political relationships with the United States (and the IMF), and the current immature state of the regional financial cooperation, the region's reliance on the IMF in case of currency crises may be inevitable for the time being. However, with a view to developing a regional monetary system in East Asia in future, it is questionable whether such reliance on the IMF in the field of crucial importance is desirable in terms of the region's common interests as well as for individual national interests.

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<sup>29</sup>) A Council of the European Union Regulation (EEC) No.1969/88 of 24 June 1988 establishing a single facility providing medium-term financial assistance for Member States' balances of payments (31988R1969).



The Institute for International Monetary Affairs (IIMA) in its report questions East Asia's reliance on the IMF for four reasons: (a) East Asian countries are underrepresented as seen in quota, staff promotion and etc.<sup>30</sup>; (b) the influence of the United States (and the European countries) is too strong; (c) the IMF has little regional expertise on or experience with East Asia; and (d) in comparison with bilateral surveillance, the IMF regional surveillance is weak and ineffective to prevent contagion (IIMA, 2005, p. 19).

The IMF's Executive Board comprises 24 members (as of July 2007), with only four representing East Asia and Oceania. The four Directors (representative combined capital quota of 16.65%) on the Board are from Japan (capital quota of 6.02%), China (capital quota of 3.66%), Australia, which represents a 14-country group including Korea (combined capital quota of 3.85%), and Thailand, which represents a 12-country group including Indonesia (combined capital quota of 3.12%). Given that these countries together account for some 30% of global GDP (on a purchasing power parity basis), 25% of export, and over 60% of foreign exchange reserves, they are definitely underrepresented.

The IMF's regional surveillance mainly covers monetary unions in Europe and Africa, and has not allocated much resource to East Asia and Latin America as a region. Some argue that international financial institutions in these regions should be utilized much more. The IMF "has traditionally been wary of mutual support facilities among central banks and/or governments at the regional level<sup>31</sup>."

Furthermore, the Report by a Group of Independent Experts on External Evaluation of IMF Surveillance points out important problems with the IMF's surveillance system. First, knowledge learned from bilateral Article IV consultations is accumulated in the departments directly involved and is not transferred across departments. In the surveillance context, this manifests itself in an inadequate cross-fertilization between multilateral and bilateral surveillance, and in insufficient use of what is learned in different countries. More importantly, second, the report raises questions about the IMF's ability to make judgments, saying that "The Executive Board spends a great deal of time on surveillance matters, especially in the concluding discussions of Article IV consultations. However, all agree that these discussions are not well focused. And despite the important peer review role that the Board has in principle, it has little ownership of surveillance priorities<sup>32</sup>."

While the IMF's surveillance is designed to ensure economic and financial stability in the international community and in member countries, in reality,

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<sup>30</sup> On August 31, 2006, the IMF agreed to increase the capital quotas for the four countries of China, Korea, Turkey and Mexico (the combined increase for the four countries is 1.8 percentage points). (Reuters, August 31, 2006).

<sup>31</sup> External Evaluation of IMF Surveillance," Report by a Group of Independent Experts, IMF, 1999, pp. 28–29.

<sup>32</sup> External Evaluation of IMF Surveillance," Report by a Group of Independent Experts, IMF, 1999, p. 13.

currency and financial crises do often occur around the world. Frankly said, with respect to its aim of preventing currency crises, the IMF is not fully performing its role. The Executive Board handles peer reviews through Article IV consultations with over 120 countries each year, and it would come as no surprise if Board meetings for countries and regions in which individual Directors take little interest are overwhelmed by inertia. The Directors on the Board representing East Asia must have regarded the IMF surveillance of, for example, Thailand and Korea as matters of their own, but to what extent did the remaining Board members understand key issues of these countries or were qualified to make appropriate judgments?

Such limitation the gigantic global institution inevitably faces is the most compelling reason to justify the establishment of regional surveillance in East Asia. It is true that the quality of Article IV consultations in the IMF's traditional area is generally rated highly. Since 2005, IMF representatives have attended the AFDM+3, making contributions in the areas where their strength lies (in global economic outlook, etc.). It is reasonable to maintain this relationship of cooperation going forward. However, the power of life or death over the region as a whole or over individual countries should not be bestowed on the IMF by making the liquidity support in a crisis situation conditional upon IMF programs. As a saying has it, "Heaven helps those who help themselves." The same can be said about financial cooperation in East Asia.

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