

Stephen Grenville: Policy dialogue in East Asia

What are the criteria for determining the number of groups for policy dialogue in East Asia? And the criteria for participation?

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I want to begin by clarifying the issues, as I see them. If we can define what we are trying to achieve with regional co-operation, then we will be in a better position to determine the nature of the regional groupings needed to achieve this. My brief today is to discuss the relevant criteria for groups which carry out a policy dialogue in East Asia. In defining the area of interest, I may widen this brief somewhat, because the sort of regionalism which I hope will develop over time goes well beyond policy dialogue, and indeed policy dialogue in its narrow sense does not seem to me to be the most pressing need. Policy dialogue, as it evolved in the post-War period, was largely about macro-economic policy co-ordination, and this was really only relevant for the largest countries – essentially the G3. For the rest of us, this was not a case of policy dialogue, but rather monologue – the G3 did what they could in terms of international co-ordination, and we wore the results, principally in the form of substantial fluctuation in the G3 exchange rates, which was often inconvenient to many. So there certainly remains a major issue of international macro policy co-ordination, and perhaps we might hope to have some input to it from the periphery, but this will not be central to our regional arrangements.

There are, however, important areas where regional arrangements have the potential to be very important for the development of policy: these are trade and (less certain) exchange rate arrangements. The first of these seems beyond the scope and brief of this paper, so I will leave it untouched: the second is the focus of discussions tomorrow, so that, too, I leave to others.

This still leaves important regional policy issues, including the possibility of policy co-ordination in the face of a repeat - or variation - of the 1997/98 Asian crisis - I will certainly talk about this. But the much more general, wider and perhaps more important issue relates to *globalisation* – how to maintain the momentum which has brought so much benefit (particularly to this region); how to make it work better with better rules; and how to get proper representation for our interests in the forums which determine the parameters – the “rules of the game” – for globalisation. This, in my view, should be a central focus of regional policy dialogue.

With this general introduction, let me turn to the specifics of what different functions regional co-operation might serve, grouped under the two omnibus headings of “policy co-ordination” and “globalisation”.

Policy co-ordination

Having downplayed the centrality of macro policy co-ordination in my introduction, let me now try to be more specific about where a degree of policy co-ordination will still be important. I have left aside trade and exchange rates, acknowledging the importance of each of these. But beyond these, I do not see a compelling reason why, say, the countries of Asia should be running similar monetary or fiscal policies, or even why they should co-ordinate their different macro policies. The heavy-lifting of macro policy-making is, broadly speaking, a domestic matter.¹

¹ I have argued that there is only a minor role for international macro policy co-ordination (and this largely confined to the G3). But as international interdependence increases, the need to know and understand what is happening in the world economy increases. The current international conjuncture is perhaps more coincident in its cyclical shape than would be imposed on it by globalisation as such – the coincidence of downturns in the G3 is, to a large extent, idiosyncratic. But there can be little doubt that the international linkages are much stronger than ten years ago, and in all probability will be much stronger still in ten years' time. For all of us, an ability to forecast how the rest of the world is moving will be critical to our own policy-making.

There is, however, one aspect of policy-making where regional co-operation might make a real and substantial contribution – i.e. surveillance. Surveillance is, perhaps, an unfortunate way of describing the process, because it has connotations of checking up and looking over the shoulder of policy-making in individual countries, i.e. something more intrusive than is generally acceptable in this region. When does “peer pressure” become interference? The principal objective of surveillance should not be to “catch out” and expose any policymakers who are doing the wrong thing, but rather to act as an advocate of good policies and as a catalyst for reform: the context has to be positive and supportive, not negative, proselytising, and adversarial.² Reluctance to be too assertive is, to some degree, the current characteristic, but the process needs to be given more content if surveillance is to have a beneficial effect. Perhaps I can explain the point more clearly by referring to the surveillance process as it occurs in the OECD, and in particular as it occurred in relation to Australia during the 1980s. Each year we faced the interrogation of our peers (the OECD Secretariat and two “examining” countries), who quizzed us on both macro and micro policies, invariably from the viewpoint of hard-edged economic analysis. This is not to say that they were always right, but they were always putting forward the viewpoint and input of best-practice economics. Why was this so valuable to the policy-making process? It made it easier for the national bureaucrats (who, by-and-large, agreed with these policies) to get these policies implemented, within a diverse decision-making framework in which other less-economically-rational views might well have prevailed. The fact that these surveillance examinations received quite wide publicity and added spice and fire to the policy debate was often inconvenient at the time (because we bureaucrats had to defend the then-current – imperfect – policies), but was almost always salutary and useful in moving us towards better policies.

The additional area where policy co-ordination may well be relevant is in *crisis response*. Other sessions at this conference will be looking at this issue in more detail. Specifically, the main area of co-operation here will be in the pooling of foreign exchange reserves. Building up large foreign exchange reserves has been the clearly demonstrated response to the crisis: *faute de mieux*, international capital flow volatility will be handled by substantial reserve-holding. This rather inefficient response can be made less inefficient by pooling. It is also true that *regional* groups share enough self-interest to encourage them to go beyond simple altruism: we are all going to be readier to help our neighbours than to participate in some kind of collective action for a more distant region (which argues for regional arrangements to supplement the IMF, rather than the more universal approach of the New Arrangements to Borrow). Rather than anticipate the later debate on this issue here, let me quote, with approval, Yung Chul Park (2000): “One development that has encouraged the regional cooperation in East Asia has been the slow progress of the reform of the international financial system. The urgency of reform in the G-7 countries has receded considerably with the rapid recovery of East Asia. ... As long as the structural problems on the supply side of capital are not addressed, the East Asian countries will remain as vulnerable to future crises as they were before. Instead of waiting until the G-7 creates a new architecture, whose effectiveness is at best questionable, it would be in the interest of East Asia to work together to create their own system of defence.”

Globalisation

As I foreshadowed, my feeling is that the issues of globalisation are even more important to regional co-operation than is policy co-ordination. Let me record briefly some of the characteristics of globalisation, to try to establish why policy must be attuned to the needs of this new globalised world, in order to foster globalisation and – at the same time – ensure that we all get maximum benefit from it. First, a point which is close to tautology, but full of policy implication nevertheless: globalisation means that an increasing part of our economic relations are with external parties (for many of the East Asian economies, foreign trade (exports and imports taken together) far exceeds GDP.

² As Dobson (2001, p. 26) observes: “Peers must be willing to supply constructive criticism and those in potential or actual difficulty must be willing to accept objective analysis. Unless governments are willing to enter into this kind of give and take, the regional mechanism will simply become another overlay of officialdom.”

Foreign Trade (per cent to GDP)	
Australia	36
China	42
Hong Kong	255
Indonesia	79
Japan	18
Korea	84
Malaysia	202
New Zealand	54
Philippines	99
Singapore	296
Thailand	108
United States	20

Domestic trade and investment is subject to myriad controls and regulations, even in the most “free market” economies. In contrast, international relations are lightly regulated. “The dilemma we face as we enter the 21st Century is that markets are striving to become global while the institutions needed to support them remain by and large national.” (Rodrik - quoted in *The Economist*, 29 September 2001, page 19 of 'A survey of globalisation'). Is this disparity in regulatory density reflecting some innate characteristic – that these relationships are, say, simpler – or does it reflect the greater difficulty of regulating across sovereign borders? It seems to me to be the latter, and we should address this deficiency.

The need for “rules of the game” seems, if anything, to be greater in a globalised world than in a less integrated world. One of the defining characteristics of globalisation is the importance of *scale*, as technology drives the optimal business units larger and larger in a number of important areas. The other defining characteristic is “winner takes all”, and its related concept of “first mover advantage”. These characteristics combine together to produce areas where monopoly or quasi-monopoly will be important. The old response to monopoly – to break it up and force competition – will be precluded or restricted because of the inefficiencies that would result from this action. So the alternative channel will be to achieve a network of rules which addresses the issues raised by these imperfectly competitive firms.

Given the increasingly international nature of enterprise, what is needed to complement this development are international rules, not specific to any one country, but developed in a uniform way and acceptable to all. These would address issues such as monopoly, intellectual property rights, and legal issues. Prudential supervision, capital flows, taxes and “industry policy” may also be suitable cases for treatment. In short, as closer relations impose greater need for uniformity (e.g. in tax or investment regimes), the need is to develop these in a collective international environment.

Tom Friedman (1999) has called such rules the “Golden Straitjacket”, which captures two important characteristics of the process – the degree of uniformity which globalisation will impose; and the generally beneficial nature of these rules.³

Rules to govern global relationships will generally need to be on a uniform multinational basis, but this does not preclude the need for important *regional* input, in order to ensure the applicability of the universal rules to all countries. A good set of rules requires recognition of the great diversity of circumstances and institutions between countries. One specific example here is the rules on prudential supervision. It seems quite likely that the rules relevant to banks in this region would be somewhat

³ It would be easy to exaggerate just how universal and all-encompassing the Golden Straitjacket may be. It does not seem true, for example, that tax rates will have to become uniform across countries.

different (reflecting the different degree of complexity and make-up of banks). We certainly would not want a set of international rules which unfairly penalised banks in this region, simply on the grounds that they were not the same as banks in London or New York.

At the general level, the collective wisdom of worldwide experience needs to be incorporated into the Golden Straitjacket more effectively than it has been to date. It is now part of the conventional wisdom that there were various deficiencies of perception and analysis in the international response to the Asian financial crisis. The “one size fits all” approach came out of earlier Latin American experience, and was a poor fit for East Asia in 1997. To some extent these deficiencies were driven either by inadequate representation, or by inability to have our voice heard above the confident assertions of those whose policy prescription was driven either by doctrinal interests, vested interests, or sometimes simple ignorance.

Regional groupings are the principal way of addressing this “democratic deficit”. There seems little room for debate that this region is inadequately represented in many of the forums which determine the important issues of globalisation. There seems little doubt, also, that the region pays a price for this. East Asia, with an IMF quota of less than 15 per cent, accounts for more than 20 per cent of world GDP, almost a quarter of world trade, and almost half of world foreign exchange reserves. Prominent American economist David Hale (2001, p. 8) has observed: “In the past, the U.S. government has only supported major (IMF) interventions for countries in which the U.S. had a military base. During the Asia crisis, for example, the U.S. acted aggressively to support Korea, but played a much less significant role in Thailand and Indonesia.”

The case I want to make here is that much of our efforts in regional groups should be directed towards correcting this. There *have* been very important improvements in international financial architecture since the crisis. The IMF has added new lending facilities that should be better able to handle the demands of capital account crises. The Fund has also started to pay greater attention in its work to financial markets and financial systems and has been critically examining both its policy prescriptions and its general approach to conditionality. Representation has greatly improved, with an additional eight Asian countries gaining membership of the BIS. The creation of G20 (with six Asian members) is, potentially, a good breakthrough. At a more detailed level, the negotiation of Basel II involved a degree of consultation entirely missing from Basel I (which had been tailored specifically for G10). There has been a push from the FSF, the IMF and the G20 to improve countries' resilience to crises by promoting adherence to standards and codes and there has been much discussion of ways to secure a greater role for the private sector in crisis prevention and resolution.

Within central banking circles, there had been some support for the formation of an Asian BIS given the Eurocentric focus of the existing organisation. In the event, this has been satisfied by the setting-up of a BIS office in Hong Kong and the creation of the Asian Consultative Council (ACC) of the BIS, which will give Asian central banks a greater say in the operation of the organisation. Some Asian countries have also been invited to attend some of the Basel/G10 committees associated with the BIS, although sadly not on a permanent full-member basis.

But the issue of ensuring that our voice is heard remains unresolved, with the IMF still giving inadequate place to this region, and other more representative groups (such as the G20) still to find a role for themselves in a world which is crowded with competing and overlapping institutions, none ready to diminish their own status and power, and many governed by inadequately representative views. *Who should be* represented in the councils of the world? This should not simply depend on GDP – this is important, but an equally important issue is what contribution each participant can make to the debate, and to the production of a universally acceptable set of rules. To be more specific, the G10 representation is deficient not just because of its limited numbers, but because of the uniformity of view of its European-dominated membership – too many people with the same viewpoint.⁴

The development of the Globalisation Rules should be a two-way process – the regional groups give input into the rule-making, and then act to put these rules in place in their individual countries (or at least adapt their own rules to fit the straitjacket). The regional groups “spread the word” in order to improve policy. This is closely related to the idea that policy improvement can come out of the surveillance process, but it adds the extra point that better policy can also come out of a process of swapping ideas and simply observing the way other countries go about doing things. The process of globalisation is forcing a degree of uniformity or similarity on policies, and to the extent that this is “best practice”, the quicker we all adapt to it the better.

⁴ For more discussion of the role and rationale for regional arrangements, see Grenville (1998).

What does this mean for the shape of regional arrangements?

As a preliminary to these issues, we need to note that international dialogue takes place at the multilateral, regional and bilateral levels. We should not be surprised or concerned at this “layering”. Nor should we be overly concerned if there is a fair degree of overlap between groups and meetings. If an issue is important, then it probably needs to be discussed in a variety of forums, each of which will bring different insights to bear. Checks and balances are important. Groups are not simply about getting together to make decisions: they are often about getting together in order to learn about decisions or discussions which have taken place elsewhere. So we should not be surprised to see, for example, Finance Ministers meeting together separately from Central Bankers, and then, separately, the two will meet collectively.

We certainly should not allow some ill-defined principle of “territorial exclusivity” to constrain dialogue which would otherwise be useful. When the Asian Monetary Fund was proposed after the onset of the Asian crisis, some people argued that it would overlap with the IMF (and this no doubt coloured the views not only of the Fund itself, but those who had a more prominent position within the Fund than they would have had within an Asian Monetary Fund). We should recall that, in many countries, there are three levels of government, each with its own contribution to make, and each interacting with the others in ways that should be fruitful – passing up regional issues which have been digested (in the sense of having achieved a degree of consensus), and passing down more nation-wide macro views to the regional levels. Petty territorial jealousies have no place in working out the proper number of organisations and their relationships: the issues should relate to bringing together groups with commonality of interest, and ensuring that they are linked (both upwards and downwards) in fruitful ways. This *commonality of interest* is the most important criterion for useful interaction. This does not mean that all the participants have to be at the same stage of development, but it probably does mean that they should be travelling along much the same path, albeit at different distances and speeds along that path. This commonality of interest allows the possibility of an effective consensus, which can be passed to the next level, representing the group as a whole.

What are the right *numbers* for a group? If the issues revolved around trade or currency unions, then economic analysis can offer useful guidance on which countries should be included. Who are (or potentially could be) good trade partners? What countries meet the criteria for an optimal currency area? The original APEC membership, for example, makes economic sense as a trading group because of established trading ties.⁵ But we have suggested here that some fruitful dialogue is more general and nebulous. At one level, one might ask whether it matters: the membership of European single currency was indeterminate until the last minute - it turned out to be much more numerous than most people had expected, and looking ahead it will probably become far more numerous than the original proponents envisaged. That said, there seems to be a lot to be said for keeping numbers down to manageable levels, which for practical purposes might be defined in terms of how many people can comfortably sit around the same table (I am tempted to add “and communicate with each other without the use of microphones”). What we know is that when we get to the size of universal “one country one vote” representation (as seen in the UN), effective decision-making becomes extraordinarily difficult and “lowest common denominator” outcomes often prevail. To give a concrete example of a response to the vexed issue of numbers: the G20 was, at one stage in its evolution, rather larger, but it was recognised that it had to be contracted. For surveillance, the relevant point will be that smaller groups can have much more candid (and therefore useful) discussion than can larger groups. “Small may well be beautiful”. If, over time, the various participants develop knowledge, empathy and understanding of the practical policy constraints, then so much the better.

When it comes to the task of developing *rules* (see the discussion above on globalisation), the important thing is for the rules to be developed by *experts or technicians* – those who know the nuts and bolts of a particular issue rather than the arm-waving generalists. If the degree of detail in domestic rules and regulations is any indication of what it takes to ensure good and efficient commerce *within* countries, why should international dealings require less complexity? These rules may well be the same ones which apply in domestic jurisdictions, but it is only the technicians who can give an accurate reading on whether this is appropriate or not. When compromise is needed, the compromise will be on the basis of technical and expert issues, and not on the basis of voting power at the table.

⁵ See Garnaut (1993, p. 308).

Two historical analogies

The obvious model for policy co-ordination in the broad sense is Europe, which over a period of four decades has progressed to economic union despite a history of hostile relations between members. Europe's success can be attributed to two main factors. Firstly, the economic dynamic: exploiting the obvious economic advantages which follow from geographic proximity. A second important factor in Europe's success was the underlying political imperative – a firmly held view on the part of a number of politicians of the need to pursue greater integration so as to reduce the prospects of future conflict. This was actively supported by the United States.

The G10 had a much more specific genesis, formed from the countries that agreed to provide a loan facility to back up the IMF's resources in 1962. These resources were to be made available in the event of potential impairment of the international financial system, and therefore only to the G10 countries themselves. Over the intervening years, the G10 has come to be central to issues governing the world financial system, both in the context of the IMF and the BIS. The enormously influential Basel Rules for Prudential Supervision were developed by (and, initially, for) the restricted club of the G10. The point to emphasise here is that groups which form for one purpose can metamorphose into new functions – in this case, far more important than the initial function. (We note that the G10 is also an illustration of why it is important to gain a seat at the table from the outset, since the incumbent members – particularly the smaller ones – will try to avoid having their power diluted.) The group's effectiveness over an extended period probably reflects a relatively small and focused membership. However, as the world has developed, the G10 has looked increasingly unrepresentative of the global economy, giving a disproportionate say to small European economies and no say to the rapidly developing countries of Asia and Latin America.

A couple of lessons might be drawn from the historic experience:

- groups need specific tasks to weld them together – “frank and fruitful exchanges of views” are good but not enough. The Europeans started with the Coal and Steel Community: i.e. something of real substance;
- patience is not just a virtue: it is a necessity in a world where it takes time to build institutions. Progress is not steady: it may stall for a time, and the group has to hold together waiting for the tide to turn;
- there *is* a sense of community and common interest stemming from geographic contiguity, which goes beyond simple economic linkages.

If progress towards closer international relations is important, then institution building will be an important element. “Virtual” secretariats may have their place, but real bricks-and-mortar institutions, with effective and active secretariats, will be needed. Charles Wyplosz (2001) makes a compelling case that the progress of European integration was hugely assisted by the presence of Europe-wide institutions, which could provide some on-going momentum and in particular could “pull a plan out of the drawer” when the country representatives were ready to discuss the next step. It is only if there are bureaucrats with an on-going vested interest in pushing forward that such plans will be ready – waiting in the “bottom drawer” – to put on the table when circumstances are propitious.

How well do current groups “fit”?

In the detailed discussion here, I have put to one side the issues of trade and exchange rate co-ordination. But now, when we turn to see how the existing regional institutions meet these needs, we should put the full range of regional arrangements on the table.

- APEC is the broadest regional grouping, bridging, most importantly, East Asia and North America, but also incorporating the likes of Chile, Mexico and Russia. Its predominantly trade focus has seen its fortunes wax and wane with developments in global trade, although the addition of Finance Ministers' and Leaders' meetings have broadened its coverage. Its principal achievement to date has been the Bogor Declaration under which developed countries agreed to strive for free trade and investment by 2010 and developing countries by 2020. However, even this has shown the tensions inherent with a relatively disparate group, with initial calls by some countries for a binding and measurable process significantly watered down. The Finance Ministers' process has focused on encouraging regional

dialogue and promoting capacity building and may not be suited to a more substantive agenda, particularly given political tensions between China and Taiwan.

- The Manila Framework Group has a broadly similar East Asian-North American structure. It had its genesis in the push for an Asian Monetary Fund in the midst of the Asian crisis. It is seen as proving one of the better surveillance mechanisms among the regional groups and also takes an interest in global architecture issues. It could be (but is not yet) the forum for developing regional positions which are then taken to world forums such as IMFC and G20. One of its main initial functions was to provide a co-operative financing arrangement to supplement IMF resources. This was initially reflected in the second line of defence facilities offered to Indonesia and Korea. More recently the idea has been revived, with discussions underway on the possibility of a more formal on-going arrangement.
- EMEAP is a narrower group in two senses. It is a purely central bank forum, drawn from the East Asian core of the above two groups. EMEAP's stated goal has been to strengthen the co-operative relationship among the central banks of the region, although various members have held ambitions of the group becoming a more substantial organisation, along the lines of the BIS. The furthest EMEAP has moved down this track is a system of bilateral repurchase agreements over US Treasuries, to provide short-term foreign currency liquidity support. EMEAP's strength is its specialist working groups, which promote good practices and better understanding at a technical level. This is, potentially, the forum for developing regional consensus on such issues as capital flows (Chilean-style inflow taxes: dealing with in extremis crisis resolution). The value of the forum at the highest level is now being tested by the formation of the BIS Asian Consultative Council, which has drawn Asian countries more into the mainstream of BIS activities. This is already the forum for developing regional positions on financial issues, so the close link with the BIS is natural and logical.⁶
- Compared with other regional groups, there is perhaps a greater uniformity of interests and views within ASEAN, and it has been going longest. ASEAN has some runs on the board already with the ASEAN Free Trade Area (which has been strengthened since the crisis) and a multilateral foreign currency swap arrangement. More recently, ASEAN has set up a surveillance mechanism, with the assistance of the ADB, in an effort to foresee and forestall crises.
- The broad agenda of ASEAN+3 covers economic, social and political fields. However, its most important achievement has been the Chiang Mai initiative, which incorporates, among other things, a regional financing arrangement (building on the ASEAN arrangements) to supplement existing international facilities.

The significant momentum in ASEAN+3 may reflect East Asia's equivalent to Europe's "integrate to avoid further conflict" imperative. There is also a strong belief that the international institutions are not set up to work in Asia's favour and that Asia must therefore look after itself – particularly given the large proportion of world reserves held in Asia. This has been felt very strongly since the Asian crisis and it is no co-incidence that the Chiang Mai initiative grew around those countries that felt most aggrieved. Similarly, countries in this group have more in common than the groups that bridge the Pacific. It could also be argued that the size of the arrangement made it a more workable decision-making entity, although it is difficult to determine whether this reflects physical numbers or simply the greater uniformity of country interests embodied in the group.

Reserve pooling arrangements could have occurred within the Manila Framework Group or EMEAP, but ASEAN+3 seems to be where the action is at present. Just as G10 gravitated from its original narrow specific purpose to become the centre of prudential supervision, ASEAN+3 might be where the more general foreign exchange rate discussions occur. For our part in Australia, we are supportive of these moves, regardless of the forum in which they evolve. Obviously, we would like to have a seat at the table, since we believe Australia has much to offer from its own experience and resources. We also feel our own policy-making has been enriched through our engagement with Asia and we have certainly appreciated the input of like-minded countries from the region in the difficult international debates of recent years.

⁶ SEACEN is a longstanding grouping of central bankers, focused on South-East Asia, but with membership spread as wide as Sri Lanka, Korea and Mongolia. One of the initial aims of SEACEN was to establish an ASEAN voting group for the IMF and the IBRD. The voting group still exists and SEACEN Governors continue to meet annually, although SEACEN's significant outward contribution appears to be its training and research efforts through the SEACEN Centre.

Should the Chiang Mai initiative continue to develop towards an ultimate goal of becoming a regional monetary fund, my view is that we should support it. If there were major developments in this regard, participants presumably would want to assess whether the Manila Framework Group, the APEC Finance Ministers, EMEAP and SEACEN are still playing a unique role.

The bottom line is that it is probably too early to assess which groups will continue to play a useful role, given uncertainty over a future world trade round, G20's unformed mandate, and the future directions of ASEAN+3. We should, nonetheless, be critically watching developments among the regional groupings over the next two to three years with a view to making tough decisions when the time is right.

Conclusion

I have tried to make the case, here, that the rationale for regional groupings will not be to achieve macro policy co-ordination. The powerful case is a wider one – we have a commonality of interest because geography and contiguity still matter, even in a world of globalisation (or even more than before). It is part of a more general view that “we are not alone”. We can learn much from the experience of those around us, and the gaining of this experience is the often nebulous and formless process of talking issues through with people of common interests. We meet to discuss a specific topic, and we end up with wider knowledge, and better general understanding, of each other. If this view is correct, then regional dialogue is not inimical to globalisation: it is, in fact, its hand-maiden and ally.