

# Asian Regional Policy Coordination

Edwin M. Truman

## 1. Introduction

We are living in what many observers have called the Asian century!<sup>1</sup> This phrase has been used over the past quarter of a century to describe a fact, a conditional forecast, or an aspiration. More than 60 percent of the global population lives in Asia, and that share is not expected to decline. So one could easily agree with the projection from the Asian Development Bank (ADB 2011) that Asia's share of global GDP will return to 60 percent, which matches the percentage the region is estimated to have contributed in the year 1700. All that is necessary is for GDP per capita in Asia to converge toward the mean for the world as a whole, which would be an impressive but not remarkable achievement.

To its credit, the ADB report does not assume that this convergence is pre-ordained. The report argues that five of the seven principal economic engines of the prospective Asian century—China, India, Indonesia, Thailand, and Malaysia—must avoid the middle-income trap and achieve productivity-driven growth. The other two countries that have already achieved advanced-country status—Japan and Korea—must sustain their growth models.<sup>2</sup>

The ADB report outlines a number of actions that individual countries in the region must take at the national level to make the Asian century a reality. It stresses the additional importance of (1) regional cooperation and integration in the form of continuing open regionalism that it attributes to East Asia's success to this point, and (2) Asia's meeting new challenges, responsibilities, and obligations globally.<sup>3</sup> These latter two elements are the focus of this paper. The paper addresses two central questions for Asia and the world: (1) What is the purpose of Asian regional policy coordination going forward? (2) Will Asian regional policy coordination substitute or complement global policy coordination? At this time, Asian policy authorities, critics, and observers do not share a well-defined consensus on these questions. One admittedly somewhat oversimplified interpretation of the ongoing European debt crisis in the aftermath of the global economic and financial crisis of 2007–09 is that even more than 60 years after the

---

**Author's note:** *This paper has benefited from conversations with Joseph Gagnon and the dedicated assistance of Sarah Bagnall.*

start of the European integration project the participating countries and their citizens also have an incomplete vision of their endeavor. It is small wonder that a shared vision has not emerged in Asia.

To provide answers to the two central questions posed about policy coordination in Asia, I first examine the potential coverage and content of such policy coordination. I next consider what is meant by “Asia” in this context and how Asia fits in with global policy coordination processes. Against this background, I examine three related aspects of Asian regional policy coordination: macroeconomic policies, reserve management, and crisis management.

My conclusion is that while the countries in the Asian region have not completely exploited the scope for regional policy coordination in a number of specific areas, more ambitious efforts focused on close integration are not likely to bear fruit, in particular, if they are conceived and promoted under the banner of Asian exceptionalism—that is, the view that Asia can and should be insulated if not disconnected from global policy coordination processes and their requirements. These conclusions are based on two broad considerations: First, Asian economies differ, and will continue to differ, sufficiently in size and stage of development such that it is difficult to conceive of a successful voluntary blending of their interests. Second, the central lesson of the global financial crisis and its current European coda is that global economic and financial integration has advanced sufficiently that countries can run but they cannot hide individually or in subglobal groups of countries.

## **2. Policy Coordination: Coverage and Content<sup>4</sup>**

Countries coordinate their policies on a wide range of activities. The common denominator in the vast majority of those efforts is an attempt to achieve objectives or outcomes that maximize positive spillovers or externalities and minimize negative spillovers or externalities. Thus, governments whose *raison d'être* is to promote the common good within their borders seek to do the same in their interactions with the countries outside their borders. In principle, one cannot exclude the possibility that countries may seek to maximize benefits to their own citizens and minimize or reduce benefits to the citizens of other countries, but this type of intergovernmental interaction is more accurately described as policy coercion than policy coordination. At the other extreme, policy coordination is not about the policies of a benevolent, altruistic hegemon.

For purposes of this paper, the coverage of policy coordination is restricted to dealing with economic and financial issues and outcomes. This restriction does not greatly narrow the list of potential topics since many policy issues have an economic or financial dimension. Climate change is a prominent contemporary

example. In this paper, however, I primarily focus on macroeconomic issues, which narrows the agenda for Asian regional policy coordination somewhat further.

The content of policy coordination can also vary across a broad spectrum.

At one extreme, policy coordination may involve no more than periodic exchanges of views on issues of common interest or concern, for example, the global economic and financial outlook. These exchanges of views, in turn, may inform the policy choices of participating policymakers, but they are left individually and independently to draw out what they find useful from the process.

Further along the spectrum, policy coordination may involve reviews of the economic and financial policies of participating countries. This type of policy coordination activity is often called “surveillance.” It can, in turn, take a number of different forms: (1) a mere show-and-tell presentation of policies and prospects, (2) a commentary from other countries or an impartial facilitator on those policies and the outcomes they are likely to produce, (3) a more rigorous application of common standards and collective judgments to the policies and prospects of individual countries, or (4) ultimately, the potential for sanctions. In general, the first two forms are more common than the third or fourth.

A third point along the spectrum of policy coordination involves agreement upon joint or parallel policy actions through which countries cooperate to achieve a common agreed objective. Generally, this type of policy coordination is either focused on a specific issue (for example, money laundering) or it is an ad hoc effort to deal with a particular situation, such as a financial crisis.

A final point along the spectrum of policy coordination involves the continuous adjustment of policies in order to achieve a common objective or objectives, such as full employment and price stability. This type of policy coordination may involve guidelines or rules, frequent reviews, enforcement devices, and prior commitments that sacrifice a considerable degree of sovereign latitude in the interests of achieving better outcomes for all countries on average over time.

A realistic appraisal of Asian regional policy coordination is that it has passed the first point on the spectrum; it has embarked to some degree on a mild form of the second (surveillance) point; there is a modest record and some further scope for activities that would qualify under the third point, such as the Chiang Mai Initiative and its several enhancements; and the final point remains a distant objective advocated by some visionaries.

The requirements of effective international coordination of economic policies at any point along the spectrum, save a modest process of exchanging views, are demanding. They involve five key elements: identification, a shared diagnosis, agreed policy actions, scope for midcourse policy corrections, and

learning lessons to prepare better for the future. Thus, the requirements start from the status quo, extend to crisis management, and conclude with steps to improve crisis prevention going forward.

These five elements can be illustrated by considering the unfolding of the recent, and many would say ongoing, global economic and financial crisis.

While a shared diagnosis of a problem and its causes is critical to the success of economic policy coordination, an essential prior condition is the identification of the problem or, possibly, problems. Without the identification of a problem, there is no need for diagnosis, shared or not. Problem identification is especially difficult in the economic sphere, where economic and financial outcomes are inherently imprecise because of incomplete information. Any number of factors could be cited as the cause of a problem, and there is often disagreement on when these factors are determined to have come into play.

What was the date of the start of the global financial crisis? When should it have been identified? For some policymakers around the world, the date was September 15, 2008, when Lehman Brothers filed for bankruptcy following a frantic but unsuccessful weekend of activity in the United States to try to spare Lehman that fate. Clearly, however, identification of the problem in mid-September was too late; the crisis had already reached a crescendo. Does that also mean that on July 3, 2008, when the European Central Bank (ECB) raised the minimum bid rate on its refinancing operations from 4 to 4.25 percent, it was unmindful of the financial crisis that was breaking over the U.S. and European financial systems? Bear Stearns had been rescued more than three months earlier (March 16), which some experts cite as the starting point of the crisis. Eight months before the Bear Stearns rescue, however, on August 9, 2007, the ECB responded to the financial market turmoil surrounding BNP Paribas freezing deposits in three of its investment funds by injecting large amounts of liquidity into the market at the then-prevailing interest rate of 4 percent. It would appear that the problem predated that action, even if the problem was only vaguely identified by then.

We might say that the problem might have been identified by August 2007 at the latest, but Bear Stearns felt impelled to rescue one of its hedge funds on June 23 of that year. On February 27 and March 5 and 13 of 2007, the volatility index on the S&P 500 spiked, but markets appeared to shrug off those events. Throughout 2007, policymakers apparently were unaware of—or at least inclined to underestimate—the underlying problems in the U.S. housing and housing finance markets despite the fact that the U.S. residential construction peaked in the fourth quarter of 2005. Maybe the underlying problem or problems should have been addressed before the end of 2005.

In fact, the problems that led to the global financial crisis and Great Recession were not identified early enough by the broad spectrum of policymakers around the world to position them to prevent or significantly mitigate the effects of the crisis before it was upon them.<sup>5</sup> Policymakers were thrown into crisis management mode before they had identified the problem or agreed on a diagnosis.<sup>6</sup>

In Asia and many other areas of the world outside of the United States and Europe, it is common to date the start of the global financial crisis with the events of September 2008. Indeed, many observers, not only in Asia, but also elsewhere, spoke of the decoupling of emerging market and developing economies from the problems that began to affect the United States in 2007. Some spoke of economic recoupling in which emerging market and developing economies would pull the United States out of an economic slowdown—a slowdown that had already become a recession by the end of 2007, though the National Bureau of Economic Research (NBER) had not yet pronounced on the subject. Even in Europe, there was a view during the first three quarters of 2008 that the principal effects of whatever was going on would be limited to the United States. Why else would the ECB have raised its policy interest rate in July 2008?

Once the global financial crisis was identified, even for those who recognized its reality in early 2007, the diagnosis of its causes proved to be challenging. The candidate causes were legion: the U.S. housing market's uncontrolled boom and similar booms elsewhere; the complex, opaque, and inadequate structure of housing finance in the United States; the lax and incomplete supervision of financial institutions in the United States and elsewhere; the evolution of engineering in financial markets; the capture of regulators and politicians by financial institutions that were too big to fail; the incentives or lack thereof for participants in financial markets; the overly easy monetary policies of the United States and some other major countries such as Japan and arguably the euro area; the fiscal deficits of the United States and other countries; growing global current account imbalances; inappropriate exchange rate policies; the global savings glut; the dearth of investment demand in the right places; etc.

By November 14–15, 2008, when the G-20 leaders met in Washington as the crisis reached its peak virulence, policymakers collectively agreed that the global financial system was under intense stress and the deepening downturn in advanced countries was paving the way for recession throughout the world economy, posing an immediate threat of a global depression and signaling the need to act to restore global growth and financial stability. The G-20 leaders' identification of the problem mentioned only “serious challenges to the world

economy and financial markets.” The depth of their collective diagnosis did not extend much beyond that rather bland statement, which was accompanied by a long list of presumptive causes.<sup>7</sup>

The reasons for the lack of precision in diagnosis and the associated lack of consensus on the appropriate framework for arriving at such a diagnosis can be found in differences in economic philosophies among (as well as within) governments, views about how economies work best or better, explicit or implicit models of national and global economies, explicit or implicit coefficients in those models even when they are broadly similar, and the preferences or priorities of policymakers and political and government leaders. In many cases, the priorities of policymakers differed because the crisis, though potentially severe, affected individual countries differentially. For most emerging market and developing countries other than those in Central and Eastern Europe, the crisis was not a serious issue until after the Lehman bankruptcy. The attention of policymakers in most emerging market countries, as well as the ECB at least in part, was focused on rising inflation, and many would argue appropriately so. The global economy had overheated, but that diagnosis also had been missed.

In economics and finance, as well as medicine, the shared diagnosis of a problem and its causes is only the second step after a problem has been identified. The third step is treatment in the form of agreed policy actions, which is where the initial consensus may break down. Because many policy actions have side effects on other countries resulting from economic and financial spillovers, in a global economic and financial crisis, it is desirable that actions be coordinated. Otherwise, some countries may find themselves unprotected, for example, from sudden withdrawals of access to market liquidity. Other countries may enjoy positive spillovers, for example, increased exports helped by the fiscal stimulus programs in importing countries, without incurring any costs measured in terms of buildups of government debt. They are free riders.

Also there are inevitable differences in strategy among different countries. Should the authorities in affected countries try to repair the financial system first so it can support economic recovery—for example, by recapitalizing, liquidating, consolidating, or nationalizing weak financial institutions? Or should the macroeconomy be fixed first to allow ailing financial institutions to grow out of their problems?<sup>8</sup> Are the strategies employed to address immediate problems—for example, blanket deposit guarantees—likely to create moral hazard problems down the road by making depositors complacent about always being repaid? Will financial rescues and stimulus programs lead to unsustainable public-sector deficits? To what extent should the global economy and financial system rely on market forces to provide equilibrating mechanisms rather

than apply rules, guidelines, and policy actions to restrain, curtail, or otherwise police market forces? What is the right balance between treating symptoms in the short run—for example via monetary and fiscal stimulus programs and rescues of financial markets and institutions—and bringing about fundamental structural changes—for example, by raising capital and liquidity standards and addressing medium-term fiscal solvency?

The global financial crisis and Great Recession revealed the tension between short-term fixes (repair of economies and rescues of financial institutions) and longer-term structural reforms (repair of public-sector balance sheets and comprehensive financial regulatory reform). Therefore, it is not surprising that, as soon as the worst of the crisis was over by the end of the second quarter of 2009, the attention of many policymakers turned to exit strategies. For some countries, it was imperative to address the residue of the crisis response, and for others it was premature to consider any exit strategy when the recovery of their economies remained precarious. As a result, the scope for a coordinated approach to adjust earlier agreed policy actions tended to dissipate as national authorities retreated into consideration of the specific needs and circumstances of their own countries and to distance themselves from engagement in coordinated policy actions directed at a common goal.

By the fall of 2010, the scope for midcourse policy corrections—the fourth element of policy coordination—was limited. The United States remained mired in a low-growth recovery. Consequently the Federal Reserve adopted a monetary policy that involved a second round of large-scale asset purchases popularly known as quantitative easing two or QE2, following its first program of asset purchases starting in November 2008 and extending through March 2010. At the same time, some other economies apparently had returned quickly to health, and their policymakers faced a need to restrain demand but also to deflect at least some of the influence of their doing so on their exchange rates. After the increase in risk aversion to assets issued by emerging market countries waned, many of these countries were inundated with unwanted capital inflows. This sparked a fresh round of debate about the role of controls on capital movements in an increasingly financially globalized economy, and about the nature and extent of any spillover effects of monetary policies in the source countries that gave rise to such flows, as well as about the effects of one country's controls on capital flows to other countries that did not impose controls.

A year later, at the end of 2011, disagreements about QE2 have been replaced by larger concerns, and the scope for further policy corrections may be even more limited than a year previously. The global economy appears to be headed for a substantial slowdown that may be significant for some countries or

regions. The prospective global slowdown has been associated with an incomplete recovery of the U.S. economy and financial system and with the effects of the chapter of the global financial crisis that is known as the European sovereign debt crisis. The political and economic scope for additional coordinated policy actions is limited.

Although most observers would agree that the global economic crisis of the first decade of the 21st century has not yet convincingly ended, this has not stopped policymakers from beginning to draw the lessons of the crisis for reform of the global financial system and for the framework for national economic policies and international surveillance of economic policies, in the context of the G-20's aspirations for strong, sustainable, and balanced growth. Additionally, in the wake of the crisis, policymakers have felt compelled to reexamine the international monetary system and the role that possible flaws in that system—as it had evolved since the breakdown of the Bretton Woods exchange rate regime in the early 1970s—may have played in the global financial crisis and Great Recession. These efforts—which may be premature because the crisis is not over and there is a lack of the perspective necessary to draw complete lessons—are an important part of the policy coordination process. Crisis prevention, like financial supervision and regulation, will never be perfect. However, that fact does not excuse policymakers and observers from drawing lessons from crises in order to reduce the incidence and virulence of crises in the future.

Turning from the elements of international policy coordination to the content of the process, successful international economic policy coordination is about achieving Pareto-improving outcomes that do not require an overt sacrifice of national sovereignty or substantially reduced national control over domestic economic policy tools. International economic policy coordination is about the promotion of economic growth and financial stability as common objectives, whether conducted regionally or globally. It is not about charity or altruism. The search for acceptable outcomes is primarily the result of dialogue and persuasion rather than the overt exercise of economic or political power and influence. This capsule characterization of the economic policy coordination process should be qualified, however, in several respects.

First, international economic policy coordination is a repeated, continuous game. Therefore, the participants have some incentive to be forward looking and to adopt approaches that may be awkward for them politically in the short run, but from which they expect to derive benefits in the future. One example is the adoption of common rules, frameworks, or guidelines that constrain national sovereignty to some degree but promise greater certainty and stability



in the future. Another example is participation in a collective effort to support another country, for example, through an International Monetary Fund (IMF) economic program or coordinated intervention in foreign exchange markets. The immediate benefits to a participating country may be marginal or even slightly negative, in the sense that domestic political opinion is skeptical, but over the longer term, the cooperating country is more likely to be assisted if and when it finds itself in similar circumstances.

Second, it follows that the participants in the international policy coordination process have some leeway in making commitments. For example, they can agree to a structure or course of action that is not demonstrably in their country's interest as long as it is not clearly against their country's interest. In addition, they can fudge their commitments through the use of language that is not specific or points to actions in the distant future.

Third, the economic and financial significance of the countries participating in the international economic policy coordination process matters to the nature of agreements on actions. But no country has complete freedom to dictate terms or solutions. Thus, the United States, the most important player in the policy coordination process over the past 40 years, even as U.S. influence has diminished in influence over the past 10 years and in particular relative to the immediate post-World War II period, has had disproportionate influence over international economic policies. To the extent that the United States has had its way with initiatives over the past 40 years, its success has flowed more from persuasion than from its economic and political power. This is an important, if not universally accepted, qualification that has operational implications for the countries of Asia as their leaders consider their individual and collective roles in policy coordination over the balance of what they hope will be the Asian century.

Fourth, institutions, both formal and informal, matter. The formal institutions of international economic policy coordination over the past 40 years are those established by international treaty or agreement such as the IMF, Bank for International Settlements (BIS), Organisation for Economic Co-operation and Development (OECD), World Trade Organization (WTO or its predecessor, the General Agreement on Tariffs and Trade (GATT)), World Bank, and regional development banks.

The informal institutions of international economic policy coordination include the various Gs: Group of 10 (G-10) major industrial countries formed in 1962 around the establishment of the General Arrangements to Borrow by the IMF from these countries, which now number 11 and have included Japan from the start; the Group of Five (G-5) formed in 1974, which is a subset of the G-10 that excludes Canada, Belgium, Italy, the Netherlands, Sweden, and

Switzerland; the Group of Seven (G-7), which includes Canada and Italy;<sup>9</sup> and the Group of Twenty (G-20) formed in 1999 at the level of finance ministers and central bank governors in the aftermath of the Asian financial crises, which includes the G-7 countries plus representatives of 12 other countries (Australia plus 11 emerging market countries) and the European Union (EU). In addition to Japan, the G-20 includes four other Asian countries (China, India, Indonesia, and Korea) as well as arguably a fifth (Australia). Informal groups of more specific relevance to Asia include the 10-country Association of Southeast Asian Nations (ASEAN), the ASEAN+3 (China, Korea, and Japan) associated with the Chiang Mai Initiative (CMI), the East Asia Summit or ASEAN+6 (adding Australia, India, and New Zealand and including Russia and the United States in the 2010 and 2011 meetings), and the Asia Pacific Economic Cooperation (APEC) forum.<sup>10</sup>

Bodies like the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) are quasi-formal.<sup>11</sup> They exist by informal agreement of the participants. The participants determine the membership of the groups. National authorities formally implement decisions reached by the participants in bodies such as the FSB and can and do exercise discretion in doing so, though significant deviations from an international agreement could lead to consequences for the jurisdiction in question and for its financial institutions.

Formal institutions matter to international economic policy coordination because they are the principal means through which many informal decisions may be implemented, for example, with respect to reform of the international monetary system, the augmentation of the resources of those institutions, or conducting studies of various international economic and financial issues. Informal institutions matter because they often are the relevant forums for decisions about ad hoc policy actions as well as about institutional changes. They also matter because they are a primary locus of continuing dialogue among officials. Moreover, those informal dialogues contribute to exchanges of information that arguably improve economic policy formulation at the national level.

Two broad implications should be drawn for Asian regional policy coordination from this review of international economic policy coordination in general.

First, the achievement of consequential results from policy coordination is demanding. Doing so requires more than a political declaration of intent. It requires close analysis, hard work, and a willingness to sacrifice a degree of national sovereignty to achieve common objectives. Those requirements are not easily stimulated by political documents. Even political agreements embodied in treaties, as in the cases of the European construction and the IMF, are not

self-implementing. Political declarations can lead national authorities to adopt an exaggerated view of what is possible via policy coordination in terms of disciplining the policies of other participants and of the availability of assistance at times of crises. In addition, their citizens may not understand the extent of national sacrifice needed to achieve a declared common objective. Asian authorities should take care not to promise or expect too much from the processes of policy coordination in which they participate.

Second, Asian countries participate in various global institutions of policy coordination, formal and informal. The extent of that participation has increased dramatically since the late 1990s in recognition, some would say belated, of the increasing relevance for the global economy of the economic and financial policies in Asia, and vice versa.<sup>12</sup> It follows that any discussion of Asian regional policy coordination cannot and should not ignore the global dimension either substantively or institutionally. This observation naturally leads to a consideration of what is meant by Asia in the context of Asian regional policy coordination.

### **3. Policy Coordination: What Is Asia?**

In any discussion of international policy coordination, it is appropriate to ask which countries' policies are being coordinated, as well as what the objectives are and how they are being addressed. This section discusses these "which country" issues as they apply to Asia. What is Asia for purposes of Asian regional policy coordination?

The broadest definition of Asia is the 48 regional members of the Asian Development Bank.<sup>13</sup> The ADB uses the classification "developing Asia" to include 44 of its members. This classification excludes Australia, Japan, and New Zealand and often includes Brunei Darussalam as the 45th country in the group. At the same time, the IMF classifies 30 economies as developing Asia. In addition to Australia, Japan, and New Zealand, the IMF excludes from this category four newly industrialized Asian economies (Hong Kong, Korea, Singapore, and Taiwan), two nonmembers of the IMF (Cook Islands and Nauru), and eight former republics of the Soviet Union largely in Central Asia, and Mongolia all of which are included in the ADB classification.<sup>14</sup> In addition, the World Bank divides developing Asia into the eight countries in South Asia and the 24 countries of the East Asia and Pacific. The latter group excludes Singapore and includes Korea.

Thus, Asia can be defined in many different ways and potentially includes a large number of countries. On the other hand, thirteen economies in the IMF category of developing Asia and the four newly industrialized Asian economies

account for 98 percent of total estimated 2011 GDP of the 34-economy group measured on the basis of purchasing power parity (PPP).<sup>15</sup> Those 13 large economies by themselves are not part of an established forum in which their policies can be coordinated. Six of them are members of the ASEAN group, but the ASEAN also includes Brunei Darussalam, Cambodia, Laos, and Myanmar. Eight of them are in the ASEAN+3 group centered on the Chiang Mai Initiative, but that group includes Japan, a traditional advanced country. The ASEAN+6 group of 16 countries brings in India, but also Australia and New Zealand. Moreover, of the 13 large economies in developing Asia broadly defined, we have not positioned Hong Kong and Taiwan, which might be thought of as part of greater China, or Bangladesh or Pakistan. The ADB (2008) identifies a group of 16 economies as “integrating Asia.” That group is the ASEAN+6 minus Australia and New Zealand and plus Hong Kong and Taiwan. Finally there is the 11-member Executives’ Meeting of East Asia Pacific (EMEAP) group of central banks, which includes five ASEAN central banks and five of the central banks of the “plus six” (minus India) plus the Hong Kong Monetary Authority.

Asian economies are not only numerous and diverse in economic size, but also diverse in their stages of economic development. The central analytical concept that is the basis for extrapolating the emergence of an Asian century is economic convergence. In that convergence, the majority of Asians raise their standard of living on average to the levels comparable with the average for the world as a whole. Today, the average PPP-based GDP per capita in the IMF’s category of developing Asia is about \$5,500, compared with a global average of about \$11,500. However, in the broader Asian region, a number of economies are already classified by the IMF as advanced with GDPs per capita running from a high of almost five times the global average in Singapore to a low of 2.4 times in New Zealand. Even within the IMF’s category of developing Asia, GDPs per capita already exceed the global average in Brunei Darussalam and Malaysia. Malaysia’s GDP per capita is 2.8 times the average for developing Asia alone, while China’s is 1.5 times, but Indonesia’s is only 85 percent and India’s 67 percent of the average. Within the ASEAN group, the comparable figures are 24 percent for Myanmar and 42 percent for Cambodia. It is difficult to believe that common policies will serve countries with these diverse stages of development with equal effect, or that the larger and richer countries will be prepared to subsidize the economies of the smaller and poorer members of any regional group or subgroup.

It is useful to consider the relative size and economic development of the 17 members of the euro zone compared with the Asian region because Europe represents an advanced model of regional economic policy coordination. Within

the euro zone are four large economies with PPP-based GDPs of \$1.4 trillion (Spain) or more, with Germany the largest at \$3.1 trillion. But tiny Malta has a GDP of only \$11 billion, and the GDP of Cyprus is \$23 billion. However, the dispersion of stages of economic development is much narrower when indexed by PPP-based GDP per capita with a euro zone average of \$33,800. GDP per capita in wealthy Luxembourg is only 2.5 the average, with the Netherlands at a mere 1.3 times and Germany at 1.1. At the other extreme, Estonia is at 60 percent of the euro zone average; the Slovak Republic is 69 percent; and Greece is 81 percent. Ongoing developments in Europe, which has a cultural heritage more in common and less diversity in economic development than Asia, have vividly illustrated that at times of stress regional policy coordination can be very difficult, even when there is a substantial supporting (if incomplete) institutional structure to organize and implement such policy coordination in the context of a regional integration project that is now in its seventh decade.

Regional economic integration may involve many objectives. An ADB (2008, pp. 16–17) report identifies five high-priority areas for collective action: joint provision of public goods in health and other areas, management of spillover effects of economic activity and policies, coordination of regional projects, liberalization of trade and investment beyond the scope of global agreements, and promotion of improvements in economic policy coordination. The second and fifth areas are directly relevant to this paper. The report examines the opportunities for Asian regional cooperation under four headings: trade, investment, and the integration of economic activity; financial; macroeconomic policy; and social and environmental concerns. The first three headings are pertinent to the main focus of this paper: macroeconomic policy coordination.

In this context, the European Union again provides a useful benchmark for regional macroeconomic integration compared with the Asian region. To facilitate such a comparison, I draw upon the approach used by Joseph Gagnon (2011) in a recent analysis of the degree of economic integration of the countries in the euro area compared with the United States.<sup>16</sup> He finds that the degree of economic integration of the euro area is less than in the United States on two of three dimensions and that only a core group of the euro-area countries has become substantially more integrated since the birth of the euro in 1999. That core group on balance is still less integrated than the United States, treating the United States as 50 states and the District of Columbia or as a group of nine census divisions.<sup>17</sup>

The Gagnon approach is in the spirit of the analysis of Bayoumi and Eichengreen (1992). However, that earlier study also sought to distinguish between supply shocks and demand shocks. Such a distinction is important for answering

questions related to internal area responses to different types of shocks, their scale, and their symmetrical or asymmetrical nature. However, a simpler two-part approach can be used to investigate how consistently countries in a region cope with disturbances regardless of their typology, size, and origins. Gagnon adopted that approach, and we have replicated it in comparing the euro area and various groups of Asian countries in Tables 1, 2, and 3.

First, we look at the level and standard deviation of inflation, unemployment, and growth rates across three Asian regions compared with the euro zone.<sup>18</sup> Second, we report regressions of national rates of inflation, unemployment, and real growth on lags of those variables and the contemporary average of the variable for the group.<sup>19</sup> The coefficients on the lagged national variables indicate the persistence of idiosyncratic national disturbances, and the coefficients on the contemporary average variables indicate the coherence of national rates with those of the area as a whole. This is an indirect measure of linkage or integration within the group of countries—the degree to which they share common shocks.<sup>20</sup> We are interested in the comparisons with Europe, in differences across the three Asian groupings, and in changes in patterns over time.

For inflation, Table 1 shows that since 1999 the average inflation rate for the ASEAN group of countries, even omitting Vietnam, is substantially higher than the average for the euro area as a whole, which is the 10-country group in the Gagnon study. For the larger Asian groups, which are dominated by larger economies, the average inflation rates are lower than in the euro area. However, for all three groups of Asian countries the standard deviations of inflation are substantially higher than in the European group.<sup>21</sup>

The regression results reveal little persistence in Asian national inflation rates year to year, unlike two of the three euro-area groupings.<sup>22</sup> They also indicate that the degree of coherence or linkage in inflation rates is similar to, or slightly higher than, the euro area. Here one is looking for a coefficient that is close to 1.0 to indicate that inflation rates move together both closely and contemporaneously. Interestingly, there is essentially no difference among the three Asian groups, in contrast with the euro-area groups.

We also examined, as did Gagnon, whether there has been a change in these patterns compared with an earlier period.<sup>23</sup> Average inflation rates in the Asian groups have declined, but the standard deviations generally have not.<sup>24</sup> In the euro area, both measures have declined. Compared with the earlier period, national inflation performances in Asia are less persistent, but the degree of coherence across the regions appears to be broadly similar, except for the 11-country ASEAN+6 grouping, where the integration appears to have increased.

TABLE 1  
**Inflation Integration in Euro Area and Asia**

	Euro Area 1999–2010			Asia <sup>a</sup> 1999–2010		
	Core	10 Countries	13 Countries	ASEAN (5)	ASEAN+3 (8)	ASEAN+6 (11)
Average		1.8		5.6	1.2	1.7
Standard deviation for region <sup>b</sup>		0.5		2.1	1.5	1.5
Standard deviation across countries <sup>c</sup>		0.6		3.6	3.4	3.0
Standard deviation within region <sup>d</sup>		1.4		3.2	2.8	2.5
Inflation $t - 1$	-0.07 (0.10)	0.65* (0.09)	0.39* (0.08)	0.03 (0.04)	0.04 (0.04)	0.04 (0.03)
Inflation $t - 2$	-0.10 (0.10)	-0.04 (0.10)	0.00 (0.09)	-0.02 (0.04)	-0.01 (0.04)	-0.01 (0.04)
Region-wide inflation	0.71* (0.18)	0.60* (0.13)	0.81* (0.12)	0.86* (0.17)	0.86* (0.18)	0.80* (0.14)
Regression standard deviation	1.09	0.90	0.75	2.77	2.62	2.36
	Euro Area 1983–98 <sup>e</sup>			Asia 1985–96		
	Core	10 Countries	13 Countries	ASEAN (5)	ASEAN+3 (8)	ASEAN+6 (11)
Average		4.8		6.2	2.7	3.2
Standard deviation for region <sup>b</sup>		2.6		2.4	0.8	0.8
Standard deviation across countries <sup>c</sup>		2.7		3.1	3.3	3.0
Standard deviation within region <sup>d</sup>		3.5		3.2	3.1	3.3
Inflation $t - 1$	0.36* (0.09)	0.53* (0.08)	0.37* (0.06)	0.19* (0.04)	0.18* (0.06)	0.30* (0.06)
Inflation $t - 2$	-0.00 (0.09)	0.05 (0.08)	0.06 (0.06)	-0.05 (0.05)	-0.17* (0.06)	-0.11* (0.06)
Region-wide inflation	0.38* (0.12)	0.30* (0.10)	0.60* (0.08)	0.92* (0.12)	0.89** (0.37)	0.62*** (0.35)
Regression standard deviation	1.67	1.86	1.76	2.10	2.88	3.11

**Note:** Standard errors are in parentheses.

**a** ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand. ASEAN+3 adds China, Japan, and Korea. ASEAN+6 additionally includes Australia, India, and New Zealand. Vietnam is omitted from inflation regressions because it experienced hyperinflation over this period.

**b** Standard deviation of the observations on the area-wide weighted average.

**c** Standard deviation of countries' average inflation.

**d** Average of standard deviations for each country.

**e** Average and standard deviations are for the period 1981–98.

\* $p < 0.01$ , \*\* $p < 0.05$ , \*\*\* $p < 0.1$ . A p-value denotes the probability that the null hypothesis (that there is no correlation between the independent and dependent variable) is correct. P-values are inversely correlated with statistical significance.

Turning to the results for unemployment presented in Table 2, Asia has lower average unemployment rates and a lower standard deviation of the average for the three groups and within each group compared with the euro area. However, the standard deviations across countries are broadly similar to that

TABLE 2  
**Unemployment Integration in Euro Area and Asia**

	Euro Area 1999–2010			Asia <sup>a</sup> 1999–2010		
	Core	10 Countries	13 Countries	ASEAN (6)	ASEAN+3 (9)	ASEAN+6 (11)
Average		8.5		5.7	4.6	4.6
Standard deviation for region <sup>b</sup>		0.7		0.6	0.3	0.3
Standard deviation across countries <sup>c</sup>		2.4		2.9	2.4	2.9
Standard deviation within region <sup>d</sup>		1.8		1.1	1.0	1.1
Unemployment $t - 1$	1.01* (0.11)	1.29* (0.08)	1.25* (0.07)	0.92* (0.10)	0.86* (0.07)	0.86* (0.07)
Unemployment $t - 2$	-0.47* (0.10)	-0.62* (0.07)	-0.62* (0.07)	-0.24** (0.10)	-0.16** (0.07)	-0.18* (0.06)
Region-wide unemployment	0.25** (0.13)	0.19 (0.09)	0.19*** (0.11)	0.40* (0.15)	0.72* (0.19)	0.63* (0.16)
Regression standard deviation	0.55	0.93	0.85	0.62	0.54	0.54
	Euro Area 1983–98 <sup>e</sup>			Asia 1985–96		
	Core	10 Countries	13 Countries	ASEAN (6)	ASEAN+3 (9)	ASEAN+6 (11)
Average		9.2		4.3	2.7	3.1
Standard deviation for region <sup>b</sup>		1.3		0.6	0.3	0.3
Standard deviation across countries <sup>c</sup>		4.1		3.1	2.9	3.0
Standard deviation within region <sup>d</sup>		2.3		1.5	1.3	1.4
Unemployment $t - 1$	1.28* (0.07)	1.38* (0.07)	1.21* (0.06)	0.64* (0.14)	0.67* (0.11)	0.86* (0.09)
Unemployment $t - 2$	-0.61* (0.06)	-0.60* (0.06)	-0.54* (0.05)	0.08 (0.16)	0.07 (0.13)	-0.17*** (0.10)
Region-wide unemployment	0.15** (0.08)	0.07 (0.07)	0.27* (0.06)	0.13 (0.28)	-0.02 (0.27)	-0.44 (0.31)
Regression standard deviation	0.50	0.91	0.62	1.05	0.83	0.93

**Note:** Standard errors are in parentheses.

**a** ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam. ASEAN+3 adds China, Japan, and Korea. ASEAN+6 additionally includes Australia and New Zealand. India has no unemployment data over these periods.

**b** Standard deviation of the observations on the area-wide weighted average.

**c** Standard deviation of countries' average unemployment.

**d** Average of standard deviations for each country.

**e** Average and standard deviations are for the period 1980–98.

\* $p < 0.01$ , \*\* $p < 0.05$ , \*\*\* $p < 0.1$ . A p-value denotes the probability that the null hypothesis (that there is no correlation between the independent and dependent variable) is correct. P-values are inversely correlated with statistical significance.

for the euro area. Again, the summary statistics for the ASEAN group, which might be thought to be more closely analogous to the euro area, show little difference from those for the two larger Asian groupings.



With respect to the regression results for unemployment, we find quite high persistence of national trends, comparable with what Gagnon found in the euro area. We also find a greater degree of coherence relative to the regional averages, but weakest with respect to the ASEAN group. The Asian results show stronger linkages than in the euro area, in particular the Asian groups that include the larger economies. Gagnon treats the coherence of unemployment rates as a measure of labor market integration in the euro area. For Asia, the regression results suggest the dominant influence of the larger economies. Compared with the earlier 1985–96 period, the persistence in the Asia results is about the same (some increase within ASEAN), and there appears to have been a noticeable increase in coherence in the later period.

Finally, with respect to real GDP in Table 3, an alternative measure to unemployment of integration on the real side of economies, the average growth rates, of course, are higher in Asia than in the euro area. The standard deviations are sizeable for all three Asian groups and similar to somewhat higher than in the euro area, with little difference across the three Asian groups. In the recent period, there is a similar low degree of persistence compared with the euro-area results. The coherence or linkage is a good deal less than in the euro area, in particular for the ASEAN group. This is the one dimension in which Gagnon finds that the euro area is close to the United States. Relative to the earlier period, persistence in growth rates in Asia has declined and coherence has increased, broadly similar to the unemployment results.

In summary, the various active Asian subregional groups of countries on these measures are about as economically integrated as is the euro area, more so with respect to unemployment, less so with respect to growth, and about the same with respect to inflation. The extent of such integration has increased somewhat in recent decades. The Asian groups that include the large economies exhibit greater unemployment and growth integration than the ASEAN group, which some think of as the Asian core. This suggests that Asia increasingly is dominated by its large economies and supply chain relationships.

What is the implication for Asian regional policy coordination of this review of what is Asia? The principal implication is that prospects for deep regional policy coordination need to be qualified for five reasons.

First, Asia comprises a large and very diverse set of countries in size and stage of development. Unlike in Europe, there is no one single, natural group of countries that can serve as a focus of regional policy coordination.<sup>25</sup> There are various overlapping Asian groups with their own diverse memberships in size and stage of development. These facts have implications for the nature of regional policy coordination in Asia. It must take account of this diversity and

TABLE 3  
**Growth Integration in Euro Area and Asia**

	Euro Area 1999–2010			Asia <sup>a</sup> 1999–2010		
	Core	10 Countries	13 Countries	ASEAN (6)	ASEAN+3 (9)	ASEAN+6 (12)
Average		1.5		5.1	4.3	4.5
Standard deviation for region <sup>b</sup>		2.0		1.8	1.8	1.7
Standard deviation across countries <sup>c</sup>		0.8		2.6	2.2	2.3
Standard deviation within region <sup>d</sup>		2.6		2.0	2.4	2.4
Growth $t - 1$	-0.07 (0.06)	0.01 (0.07)	0.01 (0.05)	0.05 (0.09)	-0.06 (0.07)	-0.03 (0.05)
Growth $t - 2$	0.03 (0.09)	0.19*** (0.10)	0.12 (0.08)	0.10 (0.10)	-0.09 (0.07)	-0.11** (0.05)
Region-wide growth	1.20* (0.07)	1.13* (0.07)	1.02* (0.05)	0.58* (0.12)	0.70* (0.11)	0.80* (0.10)
Regression standard deviation	0.95	1.32	1.01	1.76	2.06	1.97
	Euro Area 1983–98 <sup>e</sup>			Asia 1985–96		
	Core	10 Countries	13 Countries	ASEAN (6)	ASEAN+3 (9)	ASEAN+6 (12)
Average		2.1		6.8	4.8	4.7
Standard deviation for region <sup>b</sup>		1.2		2.2	1.6	1.4
Standard deviation across countries <sup>c</sup>		0.7		3.2	2.8	2.6
Standard deviation within region <sup>d</sup>		2.0		2.6	2.7	2.7
Growth $t - 1$	0.20** (0.08)	0.44* (0.07)	0.29* (0.05)	0.58* (0.10)	0.63* (0.08)	0.64* (0.08)
Growth $t - 2$	0.10 (0.08)	-0.05 (0.07)	-0.09* (0.05)	-0.33* (0.09)	-0.37* (0.08)	-0.31* (0.08)
Region-wide growth	0.83* (0.13)	0.80* (0.10)	0.86* (0.07)	0.14 (0.12)	-0.25* (0.14)	-0.20 (0.14)
Regression standard deviation	1.44	1.44	1.04	2.15	2.25	2.28

**Note:** Standard errors are in parentheses.

**a** ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam. ASEAN+3 adds China, Japan, and Korea. ASEAN+6 additionally includes Australia, India, and New Zealand.

**b** Standard deviation of the observations on the area-wide weighted average.

**c** Standard deviation of countries' average growth.

**d** Average of standard deviations for each country.

**e** Average and standard deviations are for the period 1981–98.

\* $p < 0.01$ , \*\* $p < 0.05$ , \*\*\* $p < 0.1$ . A p-value denotes the probability that the null hypothesis (that there is no correlation between the independent and dependent variable) is correct. P-values are inversely correlated with statistical significance.

the various bodies with cross-cutting memberships. This may reduce the substantive depth of what can be accomplished but should increase the probability that it will be broad in scope.

Second, the wide range of stages of development among Asian countries necessarily will affect countries' policy priorities and how they view various policy trade-offs. This is particularly true with respect to the four largest countries: Japan, Korea, China, and India. Think about the differences among those four countries: two are advanced (Japan and Korea), one (China) is already the second largest economy in the world, but with a GDP per capita below the global average, and one (India) is large in economic size but with less than half the GDP per capita of the third country. The differences in economic development of France, Germany, Italy, and the United Kingdom are minor by comparison. And we have observed how difficult it is for those four European countries to reach consensus on regional or global economic and financial issues. The Asian countries have far more diverse national and global stakes in regional and global policy coordination.

Third, a number of the large Asian countries are major players in various formal and informal global groups involved with policy coordination. Along with the considerations already adduced, this fact points to the appropriateness of an open regionalism approach in contrast with an approach that seeks a narrow Asian advantage or to isolate or insulate Asia. However, as was the case with Europe in the 1950s and continues to be the case today, the fact that European countries and Asian countries are key players on the global stage will not prevent some within those regions from preferring regional solutions to the detriment of the global interest. This is why it has proved desirable as much as possible to lock Europe into multilateral approaches. The fact that those efforts in the past have not been entirely successful does not mean that the interests of other countries vis-à-vis Asia do not point in the same direction.

Fourth, some observers note the increasing share of Asian intraregional trade compared with the European Union or North America (ADB 2008, p. 40). But, as the ADB study points out, those trends are heavily influenced by the recent relatively rapid economic growth of the 16 economies in its core group of integrating Asian economies and the associated rapid growth in their total trade. Adjusting for the rise in Asia's share of global trade, the so-called intensity of Asian regional trade bottomed out only in 2005 after declining for 50 years. Regional integration involves more than trade, more than finance, and more than macroeconomic linkages. But by the same token a substantial degree of regional integration is a necessary condition for successful regional policy coordination. Without the integration, there would be no spillovers or externalities to motivate a search for common, cooperative solutions, but a high degree of integration is far from a sufficient condition for robust policy coordination results. Asia may be approximately as integrated economically as is the euro

area, but the euro area is less integrated than the United States. Moreover, we have seen recently that the high degree of European integration is not sufficient to prevent the emergence of threats to the European integration project that has been under way for more than six decades.

Finally, these qualifications about the realistic scale and scope of Asian regional policy coordination do not imply an empty set of prospective achievements. They do suggest that such activity is likely to fall short of the fourth point on the spectrum of policy coordination I sketched out earlier, and to be limited to ad hoc episodes and projects found around the third point on the spectrum and also fit comfortably within an overall global framework.

## **4. Coordination of Macroeconomic Policies**

Setting aside issues of the appropriate regional forum for Asian regional policy coordination and the different stages of development of the participants in the existing forums, in this section, I consider, first, within-region macroeconomic policy coordination in the current economic context and, second, some aspects of the coordination of macroeconomic policies vis-à-vis the rest of the world, extraregional policy coordination. It is useful to employ the five-element framework of policy coordination that was sketched out earlier: identification, shared diagnosis, agreed actions, scope for midcourse corrections, and learning lessons.

### **4.1. Intra-regional Policy Coordination**

Neither the stage of development of countries in the Asian region nor their current economic and financial circumstances are similar. Table 4 presents a summary of IMF forecasts of 2011 macroeconomic developments for 14 principal economies in the region with respect to growth, inflation, and current account balances. What problems can be identified that require a coordinated response?

With respect to the growth rate of real GDP, each of the economies, with the exception of Japan, appears to be experiencing healthy growth this year, as shown in the first column. However, the second column indicates that most of those growth rates are less than the average recorded during the boom years of 2002–07. Indonesia is a prominent exception, arguably along with India, Hong Kong, and Taiwan. This suggests that the countries of the Asian region have recovered from the Great Recession of 2008–09 but their expansions are tepid relative to the preceding period. Is this a problem? Perhaps the authorities in the region view this growth outlook as problematic.

On that assumption, two diagnoses are possible. First, for many countries in Asia the boom years of 2002–07 involved overly rapid growth and slower

TABLE 4  
**Macroeconomic Developments in Asia**  
 2011 Forecasts

Country	Real GDP Growth		Consumer Price Inflation		Current Account	
	2011	2011 less average for 2002–07	2011	2011 less average for 2002–07	US \$ billion	Percent of GDP
Indonesia	6.4	1.1	5.7	-3.3	16.1	0.2
Malaysia	5.2	-0.7	3.2	1.1	3.7	11.3
Philippines	4.7	-0.7	4.5	-0.3	1.5	1.7
Singapore	5.3	-1.9	3.7	2.8	58.0	19.8
Thailand	3.5	-2.1	4.0	1.2	28.0	4.8
Vietnam	5.8	-2.1	18.8	12.2	-5.7	-4.7
China	9.5	-1.8	5.5	3.4	17.0	5.2
Japan	-0.5	-2.3	-0.4	-0.2	360.5	2.5
Korea	3.9	-0.9	4.5	1.6	147.0	1.5
Australia	1.8	-1.8	3.5	0.8	-40.3	-2.2
India	7.8	-0.1	10.6	5.8	-32.8	-2.2
New Zealand	2.0	-1.4	4.4	1.9	-6.5	-3.9
Hong Kong	6.0	0.4	5.5	5.7	13.4	5.4
Taiwan	5.2	0.0	1.8	0.8	55.4	11.0

Source: WEO Database, September 2011.

growth might be welcomed. Second, although the Asian economies have recovered, that has not been the case in much of the advanced economic world, including Japan, Australia, and New Zealand shown in the table. It can be argued that the failure of many of the advanced countries to achieve takeoff speed in their recoveries has adversely affected the growth performance, and likely growth prospects, in developing Asia.

Downside risks to the global economy going forward reinforce the second diagnosis. The IMF (2011f) in its September *World Economic Outlook* marked down growth in emerging Asia in 2011 by 0.2 percentage points from its April forecast, and its 2012 forecast by a further 0.3 percentage points—growth in 2012 is projected to be a full 1.8 percentage points below that group's growth rate recorded in 2010. More important, in the IMF (2011e) outlook for the Asian and Pacific Region, the IMF staff present a global downturn scenario based on a shortfall of European Union growth of 3.5 percent and U.S. growth of 1 percent below the IMF's baseline forecast for the next two years.<sup>26</sup> In this scenario, growth in emerging Asia declines 1.5 to 2 percent below the baseline.

If the Asian regional authorities shared a diagnosis that something should be done about the prospect of slower and possibly substantially slower growth in the period ahead, what actions might be agreed? Here the situation becomes more complicated. As the middle two columns in Table 4 indicate, a number of

the Asian economies have projected inflation rates that are high, and in most cases high relative to their average experience in the 2002–07 period. Indonesia and the Philippines might be considered to be exceptions. But the IMF executive board cautioned the Indonesian authorities on October 7, 2011, that they may be too optimistic about that country's inflation prospects and advised that the Bank of Indonesia should be prepared to raise its benchmark interest rate from the prevailing 6.75 percent. Nevertheless, the Bank cut the rate to 6.50 percent on October 11.<sup>27</sup> This sequence of events not only underscores the scope for differences of view between Asian authorities and the IMF staff, management, and executive board, but also illustrates the fact that not all Asian economies face the same circumstances.

On the other hand, most of the emerging Asian economies have the fiscal space to respond to, if not anticipate, a slowdown in growth. In that respect, they have scope for correcting policy choices in the fiscal area should they now decide against taking individual or collective action in that area. This is true even though for most countries their estimated cyclically adjusted fiscal balances in 2011 are weaker than the average during the 2002–07 period (IMF 2011e, p. 16). India and Vietnam are exceptions with respect to their fiscal and government debt positions, their inflation rates, and their current account positions.

The case of Vietnam is illustrative of another aspect of Asian regional economic policy coordination. How effective have the regional authorities in ASEAN and the Chiang Mai Initiative been in conducting surveillance over macroeconomic developments in Vietnam?

The ASEAN+3 Macroeconomic Research Office (AMRO) is the organization formally responsible for such surveillance under the Chiang Mai Initiative Multilateralization. It was just established in 2011. However, the Asians meet in many regional forums in which they discuss their economic and financial circumstances and prospects. Well before the outbreak of the global financial crisis, it was evident that the Vietnam economy was overheating, macroeconomic policies were on a dangerous course, its exchange rate was seriously overvalued, and its current account deficit was widening. Policies remained largely unchanged. In fact, during the crisis, the Vietnamese authorities responded strongly with expansionary policies, digging a bigger hole for the country.

The available evidence is that countries in the region were silent in providing needed advice and warnings to Vietnam, despite being potentially on the hook to provide financial assistance to Vietnam if its international reserves came under severe pressure. (Vietnam's reserves have declined since the end of 2008.) On the other hand, the staff and management of the IMF, despite a financial relationship that was broken off in 2002, have been active in providing

policy advice through the IMF Article IV consultation process and the office of the IMF resident representative in Hanoi. As described in the conclusion of Vietnam's most recent Article IV consultation in June 2011 (IMF 2011c), the situation in Vietnam, including the country's current efforts to stabilize its economy and financial system, bears a striking resemblance to the situation in Greece, which is a country with the same GDP on a PPP-basis, except that Vietnam has the scope to change its nominal exchange rate, which Greece does not. Vietnam is hampered to some extent from allowing its exchange rate to depreciate by more serious inflation pressures than are facing Greece.

A final area of difference and tension with respect to Asian intraregional policy coordination involves external positions and exchange rate policies. As shown in Table 4, with the exception of Vietnam and India, each of the emerging Asian economies, including Korea, is projected to run a current account surplus in 2011, with five of the nine surpluses expected to exceed 5 percent of their respective GDPs. As is well-known, if all countries orient their policies in order to achieve current account surpluses, the result will be deflationary for the world economy. If a significant subset of countries, such as those in Asia, succeeds in doing so, the resulting global imbalances threaten global economic and financial stability and contribute to trade tensions.

Within emerging Asia, a strong case can be made that policies should be directed at reducing current account surpluses. Exchange rate appreciation can contribute to this process as well as to relieving upward pressures on the prices of traded goods. However, the constellation of exchange rate policies in Asia is not conducive to achieving this desirable result. China heavily manages the exchange rate between the renminbi and the U.S. dollar. The exchange rate policies of other emerging market economies in the region, with the exception of Hong Kong, range from somewhat to substantially more flexible.

One result has been that after June 2010, when China again began to ease the renminbi's peg with the dollar, and as the dollar weakened against most other currencies, the currencies of many of the more freely floating Asian currencies appreciated more against the dollar than did the renminbi, and therefore against the renminbi. In many cases, those other Asian currencies appreciated in real effective terms as the renminbi actually depreciated slightly (1.1 percent) in real effective terms from May 2010 through July 2011 on the broad measure compiled by the Bank for International Settlements. The movement of China's exchange rate during this 14-month period can be expected to have had zero effect on China's global current account position, while the current account positions of some of its neighbors have felt some pressures from the appreciation of their exchange rates, which may not be welcome.<sup>28</sup>

This pattern illustrates two basic problems with respect to policy coordination: First, China's exchange rate policy vis-à-vis the U.S. dollar conditions the exchange rate policies and exchange rate performance of its Asian neighbors, often adversely affecting their own external positions and exerting influences on their own domestic economies via spillovers from currency wars. Second, China's policy actually imparts greater volatility and instability to effective exchange rates in the region not only for China but also for its neighbors.

From this review, I conclude that the challenges to effective policy coordination within the Asian region, even among the emerging market group of countries (including Korea for these purposes), are substantial. Problems are not easily identified, diagnoses of problems are generally not shared, and the difficulties of reaching consensus on coordinated actions are many. In addition, as the discussions of the Vietnam case and the matter of China's exchange rate policy have illustrated, these countries have problems, it would seem, in speaking truth to neighbors as well as even greater problems in speaking truth to power.

In connection with the 2011 G-20 Leaders' Summit meeting in Cannes, France, the G-20 announced on November 4 their agreement on principles for cooperation between the IMF and regional financial arrangements (G-20 2011c). The principles had been endorsed previously by the G-20 finance ministers and central bank governors. Procedurally, it is a bit odd that these principles are identified with the G-20 rather than with the IMF and the relevant regional financial arrangements. On the other hand, they are nonbinding. They also fall short of the robust procedures that some have advocated.

Henning (2011), writing sympathetically with respect to both the IMF and the regional arrangements, has laid out eight constructive principles and guidelines in this area: specialization along comparative advantage, prohibition against competition in critical areas, transparency of the regional arrangements, multilateral review of the resulting regional facilities, the presumptive supremacy of IMF conditionality, policies toward bailing in the private sector, and the seniority of IMF claims.

Each of the eight headings identified by Henning resonates in the context of the ongoing European debt crisis as both important and unsettled. In particular, as is highlighted in Pisani-Ferry, Sapir, and Wolff (2011), shortcomings in IMF surveillance of the euro area (in part associated with European views that the IMF surveillance had no value added or relevance to their business and in part associated with a failure of IMF due diligence and analytical acuity) contributed to a shortfall in crisis prevention with respect to the European sovereign debt crisis.



The stated goal of the G-20 principles is laudable: “foster rigorous and even-handed surveillance and promotion of common goals of regional and global financial and monetary stability.” However, with respect to surveillance, the tone of the principles is defensive of the respective organizations and remaining at arm’s length rather than promoting integration. The need for cooperation on surveillance is recognized in the G-20 principles, but not operationalized. For example, “cooperation should respect the roles, independence and decisionmaking processes of each institution. . . . Cooperation should commence as early as possible and include open sharing of information and joint missions *where necessary*” (emphasis added). Effective surveillance is both an important aspect of crisis prevention and a necessary ingredient of efficient crisis management via policy conditions.<sup>29</sup>

The fundamental point is that it is unwise for Asia and unwise for the health of the global economy for Asian regional policy coordination to take place in a vacuum without reference to global needs, perspectives, and processes. The next subsection expands upon this theme.

## 4.2. Extraregional Policy Coordination

The citizens of Asia care about policy coordination within their region, but they also have an interest in the effects and effectiveness of the coordination of policies with countries outside their region and vice versa. Policy coordination by a region and for a region alone is not likely to produce optimal results. No global region can reasonably expect to be self-reliant. The earlier observations about the likely influence of recent and expected subpar growth in the advanced countries on the growth performance in emerging Asia illustrate that point. Spillovers through both real and financial channels are potentially two-way. Those spillovers may be identified as a problem requiring policy coordination. What is an example of a common problem in Asia?

Financial flows are influenced by conditions within the individual countries of the Asian region as well as conditions in the region as a whole. In the Asian financial crises of the late 1990s, both were relevant. In 2008–09 and again in the summer and fall of 2011, an increase in risk aversion and tightening of financial conditions outside of Asia affected net inflows of capital to the Asian region and exchange rates between Asian currencies and the dollar, as well as the Japanese yen and presumptively the Swiss franc. The IMF staff (IMF 2011e) suggest three channels for these effects: liquidation of foreign investor positions in Asian assets, repatriation of liquidity by European banks, and loss of market liquidity with respect to certain types of transactions. It is instructive that some of the evidence adduced concerning the first channel includes the fact that, as of

the end of 2010, foreign holdings of government debt issued by Indonesia were 55 percent of the total. In connection with the second channel, it was noted that Asian banks had cut back on their European exposure starting in 2010. In connection with the third channel, an indicator based on the U.S. dollar–local currency basis swap spread had widened significantly while remaining within the range that has prevailed since January 2008.

Real flows are influenced by macroeconomic policies, including exchange rate policies, and they contribute to current account positions and the net accumulation of net investment positions. These are of interest and concern to countries both in the Asian region and outside that region. In principle, countries can coordinate their policies vis-à-vis the rest of the world, but the challenges in doing so are at least as great as those with respect to achieving common intraregional objectives. How would the ASEAN countries go about establishing an objective for their collective current account position, to say nothing of the ASEAN+3 grouping of even more diverse countries?

The aim would be to arrive at a common Asian regional diagnosis of individual current account positions and a collective current account position, as well as to derive a coordinated set of policies based on that diagnosis. A hypothetical exercise of this type, and I say “hypothetical” because I know of no evidence that Asian policymakers have undertaken one, would reveal all the analytical and policy disagreements that are evident in the G-20 mutual assessment process which is intended to provide strong, sustainable, and balanced growth. Indeed, if the Asian region were to seek to coordinate their policies toward objectives in this area, they would quickly have to consider how their activities would fit with the G-20 and other similar efforts.

It is useful to step back and consider some of the analytical issues that would go into any coordinated effort at diagnosis and policy prescription in this area. The international accounts of an Asian economy involve real and financial flows within the region and external to the region. At the same time, on a net basis, real flows of goods, services, income, and transfers that make up current account balances and the net financial flows that make up the rest of the international accounts are designed to sum to zero even if available statistics do not always allow one to confirm that identity. They are two sides of the same coin. Financial flows, in turn, consist of those of the official sector, principally the accumulation or reduction of international reserves, and those originating in the private sector. One often hears two concerns expressed with respect to such flows involving emerging market and developing economies: First, analysts and officials bemoan that capital is flowing uphill, from the emerging market and developing countries to the advanced countries, from the figurative south to the

figurative north. This can be taken as an identified problem. Second, analysts and officials argue that there should be more in the way of south-to-south real and financial flows. This can be taken as the diagnosis and recommended policy action.

In the context of regional policy coordination and relations with countries and their policies outside the region, we can examine this problem and suggested policy solution. To what extent and in what respect is capital flowing from south to north? Table 5 presents some data on this question at the aggregate level of groups of emerging market and developing countries, and Table 6 does so for selected large emerging market countries with an emphasis on Asia.

First, Table 5 shows that, in the aggregate, emerging market and developing countries plus the newly industrialized Asian economies had a current account surplus in 2010. As long as a country or a group of countries has a current account surplus, it follows that they must be sending capital net to the rest of the world in some form. For these groups of countries combined, they were net exporters of capital to the tune of more than \$550 billion in 2010. The only three country groups in the table for which this was not the case were Central and Eastern Europe (which includes members of the European Union that are not part of the euro area, Turkey, and a few other non-EU countries), Latin America and the Caribbean, and sub-Saharan Africa. These three groups of “southern” countries were receiving net capital flows from the rest of the world.

However, this is only part of the story about net capital flows. As noted, the flows include official as well as private capital. If we separate out official flows in the form of changes in reserve holdings, the middle column in the table, we get

TABLE 5  
**Did the South Finance the North in 2010?**  
Country Groups (US\$ billion)

Country Group	Current account	Change in reserves	Net nonreserve capital inflow
Central and Eastern Europe	-80.5	37.1	117.6
Commonwealth of Independent States	75.3	53.2	-22.1
Developing Asia	313.2	591.2	278.0
Latin America and Caribbean	-56.9	103.5	160.4
Middle East and North Africa	183.5	102.8	-80.7
Sub-Saharan Africa	-12.2	3.0	15.2
Emerging and Developing Economies	422.3	890.8	468.5
Newly Industrialized Asian Economies	131.5	105.4	-26.1
Total	553.8	996.2	442.4

Sources: WEO Database, September 2011, and IMF *International Financial Statistics*.

TABLE 6  
**Did the South Finance the North in 2010?**  
 Selected Countries (US\$ billion)

Country	Current account	Change in reserves	Net nonreserve capital inflow
Bangladesh	2.4	0.9	-1.5
China	305.3	471.7	166.4
Hong Kong	13.9	9.2	-4.7
India	-42.8	1.9	44.7
Indonesia	5.6	30.3	24.7
Korea	28.2	27.2	-1.0
Malaysia <sup>a</sup>	27.4	9.51	-17.9
Pakistan	-3.9	2.3	6.2
Philippines	8.5	14.4	5.9
Singapore	49.5	42.3	-7.2
Taiwan <sup>b</sup>	39.9	33.5	-6.4
Thailand	14.8	31.2	16.4
Vietnam	-3.9	-1.8	2.1
Subtotal	444.7	602.4	157.7
Argentina	2.8	4.2	1.4
Brazil	-47.4	49.1	96.5
Mexico	-5.6	23.0	28.6
Russia	71.1	36.7	-34.4
Saudi Arabia	66.8	35.3	-31.5
South Africa	-10.1	38.0	48.1
Turkey	-48.4	12.8	61.2
Subtotal	29.2	199.1	169.9
Total	474.0	801.5	327.5

Sources: *WEO Database*, September 2011, and *IMF International Financial Statistics*.

<sup>a</sup> Data are derived from the "international liquidity" line in the IFS table for Malaysia.

<sup>b</sup> Data are derived from the line for Taiwan in the IFS "total reserves" table and include gold valued at SDR 35 per ounce.

a different picture. In 2010, in the aggregate, the international reserves of these seven groups of countries increased almost \$1 trillion. This was a net export of capital on official account mostly from south to north. At the same time, there was a net inflow of private capital, estimated as the difference between the total change in reserves and the combined current account, of almost \$450 billion. The private sector in the north was sending more capital to the south than the private sector in the south was sending north.

Three groups of countries are exceptions to the basic pattern. The group of Commonwealth of Independent States is dominated by the large net capital outflows from Russia on private account. The Middle East and North Africa

group have very large energy-related current account surpluses and much of those surpluses end up in public hands. We have information on the amount that goes into reserves, but we do not have data on the increased holdings of their sovereign wealth funds (SWFs). The increase in their SWFs in 2010 was almost certainly more than \$80 billion. Finally, the Newly Industrialized Asian Economies are arguably not part of the south for purposes of this discussion, and as part of the north might be expected to send private capital net to the rest of the world.

Thus, for the south in aggregate, there was a net export of capital to the north, but that net flow was more than accounted for by official flows that governments directly control. The net flows involving private-sector decisions and incentives were north to south. If governments reduced their collective reserve accumulation, there is the presumption that their currencies would appreciate, they would act to maintain activity and employment by supporting domestic demand, and their current account positions would move toward deficit in line with net private capital inflows from the north.

Table 6 provides a more granular view of these patterns, focusing on individual countries: thirteen large Asian developing, emerging market, and newly industrialized economies and the seven other emerging market countries that are members of the G-20.<sup>30</sup> The table presents the same overall picture: a large combined current account surplus of about \$475 billion, an even larger recorded change in reserves (a net capital outflow on official account) of about \$800 billion, resulting in a net private capital inflow of about \$325 billion to these 20 countries as a group from the rest of the world.

Seven of the countries had current account deficits. Thus, these countries were net recipients of capital from outside the country. In every case except Vietnam, those net capital inflows not only covered the current account deficit but also in effect financed an official capital outflow in the form of an increase in international reserves. The resulting total net private capital inflow was substantial in the cases of Brazil, South Africa, and Turkey.

For five of the thirteen countries with current account surpluses—China, Indonesia, the Philippines, Thailand, and Argentina—the increase in reserves was larger than their current account surplus. Consequently, these countries also received net private capital flows from abroad.

Each of the newly industrialized Asian economies also had a sizeable current account surplus. The additions to their international reserves were in each case slightly less than those current account surpluses. This in effect allowed for an additional small net private capital outflow from each to the rest of the world as befitting their status as advanced economies.

The remaining four countries are a mixed bag. They show net private capital outflows south to north. In the case of Bangladesh, the figures are small. In Malaysia, there appears to have been a large net private capital outflow for which I have no ready explanation. In Russia, it is well-known that private capital flight is an important phenomenon. Saudi Arabia is a country whose reserve increase probably should be augmented by other official net capital outflows.

I conclude from this analysis that, despite the large current account surpluses in many emerging market and developing countries (which is the true anomaly reflecting a flow of real resources out of these countries), it is not accurate to say that capital in those forms which respond to market incentives is flowing uphill on a large scale from south to north. It would appear that the diagnosis of the problem is incorrect. The argument is often made that the net capital flows from south to north reflect the underdeveloped financial markets in the south. Investors are attracted by the greater security, liquidity, and stability offered by financial markets in the north. The data presented in Tables 5 and 6 demonstrate that the relevant net capital flows are on official account, which are motivated by factors other than the financial development of the markets in which the assets are invested. Financial market development may affect private flows, but those net flows appear to be largely from north to south.<sup>31</sup>

What about the diagnosis and policy recommendation that there should be more south-to-south real and financial flows in particular within emerging and developing Asia? Here policies, and implicitly policy coordination, are potentially more relevant. In order to generate more net south-to-south flows, real or financial, policies in the countries in the region have to be adjusted to generate different macroeconomic outcomes. Business as usual will not bring about substantial change.

As long as Asian countries maintain settings for their macroeconomic policies—fiscal, monetary, structural, and exchange rate policies—that are consistent with the current account surpluses that we now observe, increased shipments of goods and services from country A to country B, which may be recycled to country C and ultimately back to country A, will augment gross trade flows but will have no net effect. Net increases in shipments of goods and services within Asia ultimately have to emerge from the Asian region as shipments to the rest of the world.

The same logic applies to official and private financial flows within the Asian region. If country A invests more of its reserves in country B, or its private sector increases its financial flows to country B, rather than sending the financing outside the region, the result will merely increase country B's foreign exchange reserves (which might pass them on to country C) or an offsetting private capital

outflow (perhaps to country C), but in the end the net flow of private or official capital has to leave the region. If a dollar were passed around the region adding to the aggregate international reserves of the countries in the region without a change in the region's aggregate current account position, recorded aggregate net private capital inflows would be reduced for the region as a whole. The official regional inflows would have effectively replaced the private inflows.

This broad result holds independent of the degree of development of the financial markets in the region as a result of the increased financial flows. It is a matter of arithmetic. Promotion of gross capital flows within the region in order to encourage financial market development is desirable. That is the principal aim of the BIS-EMEAP Asian Bond Market Funds, as well as the Asian Bond Market Initiative supported by the ADB.<sup>32</sup> But in the absence of an adjustment in the region's combined current account, the flow diverted from investment outside the region by one country must be replaced by a flow out of the region by another country. This follows unless the program leads to a reduction in gross capital flows from outside the region which would hardly be assured or presumably desirable. From a longer-term perspective, if increased gross intra-regional financial flows were associated with financial market deepening and this led to the recipient country becoming less concerned or defensive about capital inflows, and the country reduced its rate of reserve accumulation and, therefore, its current account balance, the intraregional inflow could be accommodated.<sup>33</sup> However, unless such a development leads to changes in macroeconomic policy settings that produce a decrease in net saving or an increase in net investment in the national income accounts of one or more countries in the region, there will be no resulting change in the aggregate figures for net private capital and official flows to or from the region as a consequence of the increased financial market integration and development.

Pongsaparn and Unterberdoerster (2011) argue and present some supporting empirical results that increased financial integration in Asia, including the liberalization and development of domestic financial markets, would contribute to global rebalancing by the region by strengthening domestic demand relative to gross output—a lower current account balance. The estimated coefficients are not highly significant, the processes of generating the effects are not specified in the reduced-form relationship, and the size of the effect is quite modest.<sup>34</sup> These results do support the case for greater Asian financial integration in order to reduce global imbalances, but the underlying mechanism involves the removal of policy barriers. This is fully consistent with my analysis that other policies have to be adjusted if increased financial integration is going to contribute to external adjustment.

In Cannes, the G-20 leaders issued a set of conclusions on the management of capital flows (G-20 2011b). The conclusions include a paragraph on the strengthening of financial sectors that notes both the pluses in terms of a country's absorptive capacity and stability and the minuses in terms of increasing a country's attractiveness as a, perhaps, temporary destination for capital flows. That paragraph is linked to the G-20 action plan to support the development and deepening of local currency bond markets (G-20 2011a). The rationale for the G-20 initiative is greatly overstated. The development of local currency bond markets can contribute to economic and financial stability and potentially affect the composition of international capital flows, but it is much more debatable whether or to what extent doing so will reduce reliance on foreign saving, attenuate external imbalances, or mitigate the need for large precautionary reserve holdings, as is claimed in the G-20 action plan.

This discussion illustrates an underlying lack of consensus in the Asian region on the framework for diagnosis of the identified problem and the design of policies to address it. As a general conclusion, in order to increase net private inflows from outside the Asian region into the region, policy adjustments are needed by the countries in the region that have the effect of reducing aggregate current account surpluses. The same prescription applies to increase the size of net *intraregional* real or financial flows. It also follows that to achieve the desired regional results it is necessary for the countries in the region to engage in extraregional policy coordination, aligning or adjusting their policies vis-à-vis the rest of the world as a whole as part of a global policy coordination process.

## 5. Coordination of Reserve Management Policies

The discussion in the previous section highlighted Asian policies of reserve accumulation. As of the end of 2010, the international reserves of Asian developing countries (IMF classification) were \$3.7 trillion, almost 40 percent of their combined GDP of \$9.5 trillion, measured in current U.S. dollars.

Asian countries have accumulated their vast holdings of international reserves for one of two reasons or a combination of both. The reserve accumulation may have been a prime objective of the macroeconomic policies (self-insurance) of Asian countries. Alternatively, Asian reserve accumulation may have been a by-product of mercantilism or the application of development models in which net exports drive real economic growth—domestic demand less than output. Whatever the motivation was, the international reserves of Asian developing countries, after increasing by \$592 billion in 2010, are projected (IMF 2011f) to increase by more than \$700 billion in 2011 and almost \$750 billion



in 2012. A controversial paper by the IMF staff (IMF 2011a) develops a risk-weighted metric of the adequacy of countries' international reserves. In an illustrative application, four of the fourteen countries with international reserves, as of the end of 2009 substantially above the comfort range suggested in the paper are Asian developing countries: China, Indonesia, the Philippines, and Thailand.<sup>35</sup> The paper notes that the international reserves of most emerging market countries have increased substantially since the end of 2009. The authorities of some countries may argue that international and domestic financial risks also have increased more than proportionately during this period. That is the nub of the challenge to international and regional policy coordination with respect to reserves and reserve management.

In the case of countries whose policies primarily are directed at current account surpluses as part of their growth strategies, excessive reserve accumulation is a by-product. In these cases, the policy coordination problem, diagnosis, and policies do not involve the coordination of reserve management policies; rather it involves the issues discussed in the previous section. When excessive reserve accumulation is identified with self-insurance, reserve management policies come into play as part of the diagnosis, but it is not clear that the resulting recommended policy actions have been effective.

With respect to regional policy coordination in Asia, bilateral and multilateral efforts have been directed at developing various institutions to share reserves, in effect to engage in collective reserve management and insurance operations. They started with the Chiang Mai Initiative. The CMI developed into the \$120 billion Chiang Mai Initiative Multilateralization, but the countries also retain an extensive Asian network of bilateral swap arrangements.

To the extent that Asian countries' policies on reserve accumulation are driven by self-insurance motives, one would expect that the various bilateral and multilateral arrangements to share access to reserves would have reduced the force of such motives. However, we have no evidence to support this view. Moreover, to the extent that reserve accumulation is driven by mercantilist motives, those motives are inconsistent with a cooperative regional or multilateral approach to macroeconomic policy coordination as discussed in the previous section.

What explains the apparent inconsistency in policies and their coordination with respect to the self-insurance motive? Several hypotheses are plausible. The receipt of support from the reserve pooling arrangements is not automatic. The pools are too small relative to potential needs. They are by definition regional in nature. As pointed out in the report of the working group chaired by Jean-Pierre Landau (BIS 2011), the resources of regional arrangements are likely

to be insufficient in the face of a common liquidity shock, whether of external origin as with the global financial and current euro-zone crisis or affecting the region as a whole like the Asian debt crises. The European experience with sovereign debt crisis tends to support the last interpretation.

Reserve pooling, whatever its shortcomings, has two principal advantages. Reserve pooling reduces the economic costs of accumulating reserves; countries pooling their reserves do not have to direct their policies toward running such large current account surpluses and in effect transfer real resources to accumulate, via official intervention in their foreign exchange markets, liabilities of other countries that yield low rates of financial return. Reserve pooling reduces the real resource cost of access to reserves. Reserve pooling also potentially economizes on the net financial costs of holding reserves. The earnings on those reserves may be lower than earnings on alternative foreign assets or the fiscal costs of sterilizing reserve increases.

It would be wrong to say that the authorities in the Asian region do not understand these arguments. It would appear to be correct to say that to date those arguments have not proved to be overwhelmingly effective in modifying policy behavior. There has been a correct diagnosis, but the policy actions have not followed the script. In this area, the Asian authorities have two alternative courses of policy coordination. First, as discussed earlier, they could adopt a purely regional approach, but the European experience suggests this approach ultimately provides insufficient financing. Second, they could promote the adoption of global reserve pooling mechanisms, for example, via increasing the relative role of special drawing rights (SDR) in the international monetary system.

With respect to the latter approach, Asian authorities have expressed considerable enthusiasm for regular SDR allocations, but they seem unwilling to embrace the type of *quid pro quo* that would make such an approach attractive to other countries. The necessary *quid pro quo* would be a firm, enforceable commitment to slow the pace of their reserve accumulation as I suggested in Truman (2010b). The central point in the context of Asian regional policy coordination, however, is that the pursuit of regional interests with respect to reducing the costs of reserve accumulation via reserve pooling involves policy coordination external to the region rather than exclusively internal to the region.

One related area where the regional authorities could coordinate their reserve management policies and at the same time have considerable impact outside their region is with respect to transparency. Greater transparency in this area would yield a dividend to global and regional financial stability by removing some of the uncertainty around the management of international

reserves. As of the middle of 2011, Asian economies (developing Asia, the newly industrialized Asian economies, and the traditional advanced economies in Asia—Australia, Japan, and New Zealand) held well over half of total international reserves with gold valued at SDR 35 per ounce: \$6.5 trillion out of the global total of \$10.6 trillion. Consequently, it is understandable that market participants and authorities in other countries are nervous about how Asian countries are deploying their reserves in terms of the currency composition of their holdings and the types of assets they hold in each currency.

A few Asian economies, including Australia, Hong Kong, New Zealand, and the Philippines, provide some information on the currency composition of their reserves as is suggested, but not required, by the international reserves and foreign currency liquidity template (Kester 2001), which is part of the IMF's special reserve diversification standard. However, the "reserves template," as it is often called, is badly in need not only of acquiring more voluntary participants but also of updating. Those Asian countries that do not now voluntarily provide the IMF with confidential reports on their reserves for release by the IMF on a consolidated basis in its Currency Composition of Official Foreign Exchange Reserves (COFER) should do so. At present, slightly more than 50 percent of foreign exchange reserve holdings are included in these data. That share has been steadily declining because of rapid growth in the reserve holdings of a number of Asian countries that do not participate, starting with China.

The Asian economies also could contribute to a reform effort in this area, for example in the context of the upcoming review of the data provision by members to the IMF, which was promised in response to the IMF's 2011 triennial surveillance review (IMF 2011d). Such an initiative would help to reduce some of the potential tensions associated with their reserve management practices. No doubt those policies are responsible, but other countries and the general public have no way of verifying that presumption.

I conclude from this discussion of Asian regional policy coordination with respect to reserve management policies that the problems are incompletely identified, the diagnoses are imperfect, and the policy actions are not fully adequate.

## **6. Coordination of Crisis Management Policies**

One reason why countries accumulate international reserves is for use in a possible crisis. Unfortunately, the evidence is that countries are more reluctant to use their reserves in a crisis than to accumulate them before the crisis, apparently for fear that a rapid drawdown of their reserves will signal that the country is in greater distress than the authorities think is the case.

Korea during the global financial crisis is a case in point. In 2008, Korea's reserves declined 24 percent over eight months, from \$264 billion in March to \$200 billion in November. But rather than rely more heavily on its international reserves, Korea sought to establish swap arrangements with its Asian neighbors as well as with the Federal Reserve System. After Korea gained access to the Federal Reserve swap network in October 2008, Korea's reserves began to rise, recovering to \$292 billion by the end of 2010. The Korean authorities were motivated, in part, it is widely believed, by a desire to avoid the stigma of going back to the IMF while there remained bitter political memories of Korea's involvement with the IMF during the Asian financial crises. Therefore, Korea did not take advantage of the flexible credit line mechanism when it was established by the IMF in March 2009. Interestingly, Korea also did not draw on the Chiang Mai Initiative, which then consisted of a set of bilateral swap arrangements, reportedly because it did not want to suffer the stigma of being the first country to use that mechanism.

Korean concerns about stigma and the IMF are extreme and troubling. Excessive concerns about stigma on the one hand and excessive concerns about moral hazard on the other have the potential to paralyze constructive international monetary cooperation with respect to the scale of international financial assistance available to a country in crisis. The problem of stigma has been misidentified. Nevertheless, Asian concerns about the mix of the amount of required adjustment and the amount of available financing during the Asian financial crises are a reality, and they have some merit.<sup>36</sup> There was an issue of the scale of financing. At the time, arguments about inadequate financing and policies that were too tough as a consequence were used by advocates of the creation of an Asian Monetary Fund (AMF). The AMF was not established, in part, because there was insufficient support for such an institution within Asia, and it could not have been put in place in the relevant timeframe to be helpful, which of course was weeks. The AMF also was not established because many authorities outside the region did not think that the world would be better off with a large free-standing institution that applied economic and financial standards of adjustment to countries in Asia that differed from those applied elsewhere in the world. I was one of those with that view. The diagnosis and recommendations for action did not match, and the AMF proposal was not supported by effective extraregional policy coordination actions.

Instead of the AMF, the CMI was established after the crisis. It has now spawned the CMIM. Those mechanisms incorporate at least in principle two key elements: the need for a supporting surveillance process and the fact that Asia, despite its apparent plethora of international reserves, cannot go it alone

financially. Links to international arrangements are essential. One can debate the nature of those links. Henning (2011) advocates a rather liberal approach. Goldstein (2011) cautions that the IMF must remain in the driver's seat, supplying the bulk of any financing so that it can insist upon applying a high and consistent standard of economic and financial reform should the Fund be called upon to assist a member country. McKay, Volz, and Wölfinger (2011) conclude that, from the standpoint of the stability of the international monetary system, a regional financial arrangement must not undercut IMF conditionality, which promotes rigorous economic management and guards against lax lending requirements, in the name of a competition in ideas that undermine the value to the system of the associated public goods. If that value is undercut, ultimately the value to the region will be cut as well.

Some observers still advocate the AMF approach for Asia, building on the CMIM and severing any links to the IMF.<sup>37</sup> Others, including myself, observe that the European sovereign debt crisis has confirmed that regions that attempt to go it alone in terms of financial support mechanisms, ongoing surveillance, and the design of conditional lending programs ultimately will reach a dead end and will need to be bailed out.

As noted earlier, the G-20 principles for cooperation between the IMF and regional financial arrangements (G-20 2011c) address the balance between regional and global approaches to providing financial assistance. They fail to go beyond the recognition that competition in laxity with respect to policy conditions on lending and facility shopping should be discouraged, which is one of the Henning (2011) principles.<sup>38</sup> Again, the need for cooperation is recognized but not operationalized.

It is increasingly appreciated that policy coordination in the management of financial crises must have a global dimension if it is to be effective. Regional policy coordination can play a role, however, in promoting global crisis management responses as well as the development of crisis management instruments. The advocacy by Korea and other countries in emerging and developing Asia for a more comprehensive global financial safety net has advanced that debate, even though not everyone is fully satisfied with the results that have been achieved to date. There remains a strong case for putting in place a mechanism for the IMF to offer financial assistance to countries caught up in a global financial crisis in which they are not prime perpetrators as long as their policies are otherwise strong, in other words responding to truly external shocks.<sup>39</sup> We have learned that it is not only the low-income countries that are susceptible to external shocks that can be seriously disruptive, but more advanced countries as well. In particular, if we do not want individual countries to continue to build

huge holdings of international reserves or to erect barriers to trade or financial flows, there is a need to develop common support mechanisms. In this area, the identification of a problem is not fully agreed upon, the diagnosis of the causes is not fully shared, and therefore action has been incomplete.

Going forward, one can hope that regional concerns and advocacy will help to push the multilateral institutions with their broader memberships to adopt approaches that they might not otherwise seriously consider. A particular area of interest and concern involves the stability of financial institutions and financial systems. During the global financial crisis, the provision by the Federal Reserve of financial support in U.S. dollars to foreign financial institutions through their home country central banks was particularly effective in stemming contagion. The amount outstanding reached almost \$600 billion at the end of 2008, but the cumulative amounts were much larger, taking into account repayments and new drawings.

I have advocated (Truman 2010a) an amendment of the IMF Articles of Agreement that would authorize the IMF temporarily to swap SDR with the central banks that issue the international currencies included in the SDR basket for their currencies. Those currencies would be lent by the IMF to other central banks specifically to support their financial institutions. This proposal has three advantages: the mechanism would (1) temporarily augment the IMF's financial resources and help to centralize this type of lending in the IMF; (2) permit the issuing central banks to use the SDR by subsequently swapping them to obtain foreign currencies if they need to offset unwelcome exchange rate depreciation pressures resulting from the liquidity support operations; (3) hopefully limit somewhat the precautionary demand for increases in international reserves, but as discussed earlier, that is more of a hope than an assured result.

It is not necessary to create such an elaborate mechanism. Another possibility would be an institutionalized global swap network along the lines of the ad hoc arrangements that were used during the global financial crisis and have been again put in place during the European sovereign debt crisis. Some central bankers resist this type of proposal. They argue that permanent arrangements contribute to moral hazard behavior on the part of governments and private-sector banks. To this argument, I would respond that the crisis alternative has been much worse, and the system has been forced to respond eventually in any case. There are advantages to reducing uncertainty *ex ante*.

A second argument that one hears from central bankers is that they do not want to be commanded to engage in lending to other central banks by the IMF, which is an institution largely dominated by finance ministries and, therefore, inherently more political. This argument also should be countered. First, there

is an advantage to a national central bank from having a multilateral organization, such as the IMF, declare that the global situation demands global cooperative solutions. This provides a degree of political cover from domestic critics of helping other countries. Second, a global swap network could be set up in which there were, in effect, three keys. One would be operated by the IMF, declaring a global need. The second would be operated by the central banks as a group, agreeing that there was such a need. The third would be operated by each individual central bank by deciding to respond to the actions of the IMF and the central banks as a group by agreeing to a specific swap operation. Would national central banks come under pressure to use their third key? Certainly, but those pressures would be there in any case. A structured approach would help to identify those countries that were more deserving from those that were less deserving.

It is again important to consider both the broader global safety net proposals and the narrower global swap net proposals in the context of Asian regional policy coordination. The Asian region is usually open to the global economy and increasingly also to the global financial system. That is a manifestation of Asia's increasing importance in the global economy and financial system. This integration requires policy coordination, but such coordination will be most effective if it operates at two levels: the regional level, in which common concerns may be articulated and proposals may be developed, and the interregional or multilateral level, in which broad support can be mobilized to address concerns affecting much of the world and to establish mechanisms serving the system as a whole.

## 7. Concluding Observations

I have argued in this paper that the purpose of Asian regional economic policy coordination should be to promote economic growth and financial stability in the region. In pursuing that objective, Asian authorities should seek to complement, rather than substitute for, global policy coordination. These conclusions are supported by four broad themes.

First, differences in the economic size and the stage of economic development of countries within Asia will condition any policy coordination in Asia. That process will be particularly demanding whether directed at developments within the region itself or toward the rest of the world. It follows that Asian authorities should not overpromise what they can achieve via regional policy coordination.

Second, the examination in this paper of three areas of actual or potential Asian regional policy coordination—macroeconomic policies, reserve

management, and crisis management—reveals that the identification of the problem is often incomplete, the diagnosis often is not broadly shared, and the policy responses are inadequate. These challenges are not unique to policy coordination within Asia, but they point to the need to conduct these activities in a broader global context to increase the probability of success.

Third, the dominant lesson from the European experience in their current crisis is that regions should not try to divorce themselves from the rest of the world in terms of economic policy surveillance, external financial support, or policy coordination.

Fourth, Asia has a central role to play in global policy coordination. The major Asian economies are already active participants, which further conditions the extent and nature of such activities within the region. Nevertheless, Asian regional policy coordination can contribute both to global policy coordination and to the advancement of the Asian century if their regional approach to policy coordination is based on the principle of open regionalism rather than Asian separateness.

## REFERENCES

- Asian Development Bank. 2008. *Emerging Asian Regionalism: A Partnership for Shared Prosperity*. Manila, The Philippines: Asian Development Bank.
- Asian Development Bank. 2011. *Asia 2050: Realizing the Asian Century*. Manila, The Philippines: Asian Development Bank.
- Bank for International Settlements. 2011. "Global Liquidity: Concept, Measurement, and Policy Implications." Report submitted by the Ad-hoc Group established by the Committee on the Global Financial System and chaired by Jean-Pierre Landau. CGFS Paper 45. Basel, Switzerland: Bank for International Settlements.
- Bayoumi, Tamin, and Barry Eichengreen. 1992. "Shocking Aspects of European Monetary Unification." National Bureau of Economic Research Working Paper 3949.
- Bergsten, C. Fred. 1997. *Open Regionalism*. Peterson Institute for International Economics Working Paper 97-3.
- Chan, Eric, Michael Chui, Frank Packer, and Eli Remolona. 2011. "Local Currency Bond Markets and the Asian Bond Fund 2 Initiative." Note prepared for the EMEAP Working Group on Financial Markets (July). Basel, Switzerland: Bank for International Settlements.
- Gagnon, Joseph E. 2011. "European Monetary Unification: Precocious or Premature?" Paper delivered at a Bruegel-Peterson Institute for International Economics Conference on Transatlantic Economic Challenges in an Era of Growing Multipolarity. Berlin, Germany, September.



- Goldstein, Morris. 2011. "The Role of the IMF in a Reformed International Monetary System." Paper prepared for Bank of Korea conference on the Future of the International Financial Architecture. Seoul, Korea, May 26–27.
- Goyal, Rishi, Chris Marsh, Narayanan Raman, Shengzu Wang, and Swarnali Ahmed. 2011. "Financial Deepening and International Monetary Stability." IMF Staff Discussion Note 11/16 (October 19). Washington: International Monetary Fund.
- Group of 20. 2008. "Declaration of the Washington Summit on Financial Markets and the World Economy (November 15)." Available at [www.G-20.utoronto.ca/2008/2008declaration1115.html](http://www.G-20.utoronto.ca/2008/2008declaration1115.html). Accessed October 22, 2011.
- Group of 20. 2011a. "G-20 Action Plan to Support Development of Local Currency Bond Markets (November 4)." Available at [www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html](http://www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html). Accessed November 9, 2011.
- Group of 20. 2011b. "G-20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences (November 4)." Available at [www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html](http://www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html). Accessed November 9, 2011.
- Group of 20. 2011c. "G-20 Principles for Cooperation between the IMF and Regional Financing Arrangements (November 4)." Available at [www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html](http://www.G-20-g8.com/g8-G-20/G-20/english/the-2011-summit/declarations-and-reports/G-20-cannes-summit-declarations-and-reports.1553.html). Accessed November 9, 2011.
- Henning, C. Randall. 2011. "Coordinating Regional and Multilateral Financial Institutions." Peterson Institute for International Economics Working Paper 11-9.
- Henning, C. Randall, and Mohsin S. Khan. 2011. *Asia and Global Financial Governance*. Peterson Institute for International Economics Working Paper 11-14.
- International Monetary Fund. 2011a. "Assessing Reserve Adequacy." Paper prepared by Monetary and Capital Markets, Research, and Strategy, Policy, and Review Departments (February 14). Washington: International Monetary Fund.
- International Monetary Fund. 2011b. "IMF Executive Board Concludes 2011 Article IV Consultation with Indonesia." Public Information Notice (PIN) No. 11/128 (October 21). Washington: International Monetary Fund.
- International Monetary Fund. 2011c. "IMF Executive Board Concludes 2011 Article IV Consultation with Vietnam." Public Information Notice (PIN) No. 11/81 (June 23). Washington: International Monetary Fund.
- International Monetary Fund. 2011d. "Managing Director's Statement on Strengthening Surveillance: 2011 Triennial Surveillance Review." Washington: International Monetary Fund.
- International Monetary Fund. 2011e. *Regional Economic Outlook Asia and Pacific: Navigating an Uncertain Global Environment While Building Inclusive Growth*. World Economic and Financial Surveys (October). Washington: International Monetary Fund.

- International Monetary Fund. 2011f. *World Economic Outlook* (September). Washington: International Monetary Fund.
- International Monetary Fund–Independent Evaluation Office. 2011. *IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004–07* (February 9). Washington: International Monetary Fund.
- Kawai, Masahiro. 2009. “Reform of the International Financial Architecture: An Asian Perspective.” Asian Development Bank Institute Working Paper Series 167 (November).
- Kester, Anne. 2001. *International Reserves and Foreign Currency Liquidity Guidelines for a Data Template*. Washington: International Monetary Fund.
- McKay, Julie, Ulrich Volz, and Regine Wölflinger. 2011. “Regional Financing Arrangements and the Stability of the International Monetary System.” *Journal of Globalization and Development* 2(1), article 5.
- Pisani-Ferry, Jean, André Sapir, and Guntram B. Wolff. 2011. “An Evaluation of IMF Surveillance of the Euro Area.” Report prepared for the IMF Triennial Surveillance Review (October). Bruegel Blueprint 14. Brussels, Belgium: Bruegel.
- Pongsaparn, Ruchana, and Olaf Unterberdoerster. 2011. “Financial Integration and Rebalancing in Asia.” International Monetary Fund Working Paper 11/243.
- Sussangkarn, Chalongsob. 2010. “The Chiang Mai Initiative Multilateralization: Origin, Development, and Outlook.” Asian Development Bank Institute Working Paper 230 (July).
- Truman, Edwin M. Forthcoming. *International Economic Policy Coordination Reconsidered*. Washington: Peterson Institute for International Economics.
- Truman, Edwin M. 2010a. “The G-20 and International Financial Institution Governance.” Peterson Institute for International Economics Working Paper 10-13.
- Truman, Edwin M. 2010b. “Strengthening IMF Surveillance: A Comprehensive Proposal.” Policy Brief 10-29. Washington: Peterson Institute for International Economics.

## NOTES

1 Wikipedia traces the origins of this phrase to a 1985 hearing of the U.S. Senate Committee on Foreign Relations, as well as to a 1988 meeting between China’s leader, Deng Xiaoping, and India’s Prime Minister, Rajiv Gandhi.

2 In 2010, these seven countries accounted for 78 percent of Asia’s population and 87 percent of Asia’s GDP. The Asian century scenario projects that these shares will be roughly maintained through 2050, and that the GDP of these countries will then compose 45 percent of global GDP (ADB 2011, Executive Summary, p. 5).

3 Open regionalism is a term conventionally employed with respect to trade agreements such as the Asia Pacific Economic Cooperation Bogor Declaration of 1994, in which benefits to partners are automatically extended to nonpartners or the nonpartners are free to join (Bergsten 1997). In this paper, I use the term more broadly to encompass all forms of

economic and financial processes and agreements and to point to agreements that promote the global as well as regional benefits.

**4** The discussion in this section is based upon Truman (forthcoming).

**5** Of course there were the Cassandras that warned of impending crisis well before 2007, but in order to instigate a policy coordination process, such warnings have to be heard and accepted broadly enough for the policy authorities, at a minimum, to consider whether a problem has been identified.

**6** The Independent Evaluation Office of the International Monetary Fund issued a comprehensive report and supporting documents on how the IMF staff and management missed signals of crisis (IMF-IEO 2011).

**7** The opening paragraphs of the Declaration of the Washington Summit on Financial Markets and the World Economy on November 15, 2008 (G-20 2008) read:

We, the Leaders of the Group of Twenty, held an initial meeting in Washington on November 15, 2008, amid serious challenges to the world economy and financial markets. We are determined to enhance our cooperation and work together to restore global growth and achieve needed reforms in the world's financial systems. . . .

During a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. At the same time, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.

Major underlying factors to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruption.

**8** These two questions were central in the considerations of policymakers in the decade following the bursting of the Japanese real estate and equity market bubbles in Japan in the late 1980s and to the handling of the Asian financial crises at the end of the 1990s.

**9** The G-5 countries are Germany, France, Japan, the United Kingdom, and the United States. The G-7 meets at both the level of finance ministers and central bank governors and the level of leaders. Russia joins the leaders to make the G-8, but the focus of that group primarily has been on issues other than economic policy coordination.

**10** The Chiang Mai Initiative Multilateralization (CMIM) also includes Hong Kong as a participant.

**11** In addition to the Asian members of the G-20 that are members of the BCBS and FSB, Hong Kong and Singapore also participate in those quasi-formal bodies.

**12** Henning and Khan (2011) emphasize Asia's underrepresentation in global governance today, but at the same time propose that Asian countries should strive to present a common view in international forums, including representing the views of Asian nonmembers of those groups.

**13** For historical reasons Russia is not a member of the ADB. Eight republics of the former Soviet Union are members of the ADB. Russia, of course, is a member of APEC and attends the East Asian Summit.

**14** The ADB and IMF classifications of developing Asia, as well as the World Bank's East Asia and Pacific group, include a number of small Pacific island nations as well as a number of large nations of this type, such as Indonesia and the Philippines.

**15** The 13 economies are Bangladesh, China, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Singapore, Taiwan, Thailand, and Vietnam.

**16** I am particularly grateful to my colleague Joseph Gagnon for his guidance on this exercise and to Sarah Bagnall for performing the calculations.

**17** The seven-country euro-area core group consists of Austria, Belgium, Denmark, France, Germany, Luxembourg, and the Netherlands. Gagnon also considers a 10-country group consisting of the 11 original members of the euro area less Luxembourg and a 13-country group of the 11 original members plus Denmark and Greece.

**18** The three Asian regions are the core countries in the ASEAN group (Indonesia, Malaysia, the Philippines, Singapore, Thailand, and for some tests Vietnam); the ASEAN group plus the three countries that are also part of the Chiang Mai Initiative (China, Japan, and Korea); and the ASEAN+6 group (including Australia, New Zealand, and in the inflation and growth comparisons India). The exclusion of Vietnam from the inflation comparisons is due to its high inflation rate during the 1985–96 period, and the exclusion of India from the unemployment comparisons is due to the lack of data for India on that variable.

**19** For this purpose we use PPP-based GDP as weights.

**20** The Asian data are drawn from the September 2011 *World Economic Outlook Database*. See Gagnon (2011) for the data sources he employed.

**21** Table 1, as well as Tables 2 and 3, reports three standard deviations. The first is the standard deviation of the observations on weighted average for the region. The second is the standard deviation of the average for each country across the region. The third is the average of the standard deviations for each country within the region. See the footnotes to the tables.

**22** We ran these regressions for 1999–2007 to see whether the results appeared to be influenced by the effects of the global financial crisis. There did not appear to be any influence, and we report the results for the longer sample period.

**23** The availability of data forced us to start with the year 1985 for the results reported in Table 1 and the following two tables, and we omitted 1997–98 because those data were likely to be strongly influenced by the Asian financial crises, which tended to affect all Asian economies in a similar fashion.

**24** The region-wide standard deviation has increased for the ASEAN+3 and the ASEAN+6 groups.

**25** It can be reasonably argued that within Europe there was not one dominant group of countries when the Treaty of Paris was signed in 1951 establishing the six-country European Coal and Steel Community of France, Germany, Italy and the Benelux countries. That group became the nucleus of the European Union, but its predecessor, the European Common Market, was rivaled by the European Free Trade Area. Even today not all major countries in Europe (Switzerland and Norway, in particular) are members of the European Union. The European Union itself is split between those countries that are part of the euro area and those that are not. Nevertheless, the European Union and its euro-area subgroup are a much more compatible group of countries in terms of stages of development than any of the candidate groups in Asia.

**26** As of late October 2011, the baseline forecast appeared to be optimistic as it assumed that Europe would pull out of its economic and financial difficulties and that the U.S. administration would receive Congressional approval of a substantial proportion of its request to blunt the impact of a prospective immediate U.S. fiscal contraction via its proposed “jobs” legislation.

**27** The Public Information Notice of the Board’s discussion (IMF 2011b) was released on October 21. The Bank of Indonesia cut the rate a further 50 basis points to 6 percent on November 10.

**28** One reason for these divergent foreign exchange movements was that the U.S. dollar depreciated 9.6 percent over this period. Following the abrupt change in global financial market sentiment at the end of July, the situation reversed, the appreciation of the renminbi continued albeit at a slower pace, the dollar appreciated, and most of the other Asian currencies, aside from the Japanese yen, depreciated sharply against the dollar, the renminbi, and the yen.

**29** I discuss these issues in Truman (2010a, b).

**30** One difference between the two tables is that the change in reserves in Table 6 is a true flow concept as recorded in the international transactions accounts of these countries, with the exception of Malaysia and Taiwan, as indicated in the footnotes. The data in Table 5 are derived from the change in the stock of reserves, which includes valuation effects.

**31** I look more closely at this argument below.

**32** See Chan et al. (2011) for a summary, as well as G-20 (2011a).

**33** See the discussion in Goyal et al. (2011).

**34** The estimated effect on the Asian current account balance is 1 percent of GDP if the Asian region moved all the way to the norm for financial integration for the world as a whole, which would be quite a move and would take some time.

**35** Korea and Singapore were not included in the sample of emerging market countries because the IMF classifies them as advanced countries.

**36** On the other hand, I have never seen much merit in criticisms of the broad content of the adjustment measures required of Asian countries during the crises. Indeed, those who complain now about that content face a logical problem when they simultaneously argue that it is the improved economic, financial, supervisory, and regulatory policies adopted in Asia that helped to shield and support Asian economies somewhat from the virulence of the global financial crisis.

**37** Two examples of such advocacy are Kawai (2009) and Sussangkarn (2010).

**38** The principles do state that the regional financial arrangements must respect the preferred creditor status of the IMF, which also is one of the Henning (2011) principles.

**39** The G-20 leaders in Cannes expressed support for a modest expansion of the IMF lending instruments to include a new IMF precautionary and liquidity line that would be available on a case-by-case basis to provide short-term liquidity to countries with strong policies and fundamentals that are facing exogenous shocks.