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The Case for East Asian Financial Cooperation

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In the past few years, East Asian regional economic cooperation has again become fashionable. I write "again" because, in a sense, it's nothing new in the millennia of Asia's history. Southeast Asian economies were trading with each other as early as the seventh century, when the Sumatra-centered Srivijaya Empire controlled both the spice route traffic between India and China and local trade along the coasts of Southeast Asia with Chinese, Indian, and Malay merchants. Flash forward to the so-called Asian miracle spanning the 1970s to the mid-1990s. During these three decades, the region sustained an average growth rate in gross domestic product (GDP) of 7 percent on the back of postwar Japan, which grew at an average of 10.4 percent from 1961 to 1969, and, later, on the backs of Hong Kong (China), the Republic of Korea, and Singapore (see table 3.1). Growth in Southeast Asian economies such as Indonesia, Malaysia, and Thailand gained momentum in the early 1990s. As a result, intraregional trade as a share of total trade rose from about 20 percent in 1980 to about 30 percent in 1990 (Burton, Tseng, and Kang 2006).

TABLE 3.1. Average Annual GDP Growth Rate
percent

Country	*1970–96*	*1970–79*	*1980–89*	*1990–96*
China	9.1	7.4	9.7	10.5
Hong Kong, China	7.4	9.3	7.3	4.9
Indonesia	7.3	7.8	6.4	8.0
Japan	3.9	5.3	3.7	2.3
Korea, Rep. of	8.0	8.3	7.7	7.9
Malaysia	7.5	7.7	5.9	9.5
Philippines	3.6	5.8	2.0	2.8
Singapore	8.5	9.3	7.5	8.9
Thailand	7.7	7.5	7.3	8.6
Average	7.0	7.6	6.4	7.0

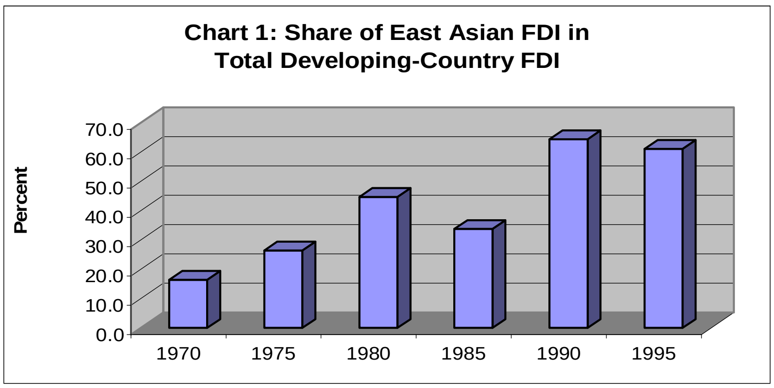
Source: World Bank 2005.

During the same period, the region became a top destination of foreign direct investment (FDI). In 1970, East Asia received only 16.4 percent of all FDI inflows to developing countries. Ten years later, the corresponding FDI inflows to the region stood at 44.7 percent, sharply rising to 64.3 percent by 1990 (see figure 3.1).

However, even as these economies became more closely linked with each other through regional trade, the financial sectors of the various East Asian countries remained in the national domain and were mostly left out of regional discussions. The creation in 1967 of the region's first formal attempt at cooperation, the Association of Southeast Asian Nations (ASEAN), successfully put together the industrial cooperation scheme and the agreement on industrial complementation, which promoted trade, investment, and tourism among member countries. The common effective preferential tariff scheme for the ASEAN Free Trade Area, signed in 1992, paved the way for free trade in the region. These early economic arrangements in the ASEAN notwithstanding, little attention was paid to the financial sector.

That changed seemingly overnight with the onset, in 1997, of the Asian financial crisis, which brought the region's high-growth years to a screeching halt. Average growth that year slowed to 5 percent, from 7 percent in the previous years (see table 3.2). By 1998, the region's economies had suffered output contractions. Indonesia and Thailand posted the largest declines in output, at 13 and 10 percent, respectively. On average, the region's growth plummeted by 4 percent.

FIGURE 3.1. Share of East Asian FDI in Developing-Country FDI



Source of raw data: World Investment Report [2005]

Source: Data from UNCTAD 2005.

At the onset of the Asian financial crisis, I was finance minister of the Philippines and had the fortune (or misfortune) of being the chair of the Asia-Pacific Economic Cooperation Finance Ministers. Asia and the rest of the world were in shock at what had just happened. Many openly wondered if it meant an end to decades of economic progress; others questioned if the main paradigms associated with the Asian model, such as the export orientation riding on the back of low-priced labor, were inappropriate or faulty to begin with. Some asked if the region had embarked on its economic journey too much too soon. I keenly remember the informal, but raging debate that took place during the 1997 World Bank–International Monetary Fund meeting held in Hong Kong between Malaysian Prime Minister Mahathir Mohamad and George Soros on who was to blame for the economic disaster: Asian economies steeped in “cronyism” or “heartless” fund managers engaged in global currency speculation.

Clearly, both were factors, but, more importantly, what the Asian crisis did was highlight the region's weaknesses, as well as the changing global economic scene. First, the inevitability of globalization brought with it both opportunities and risks. In the case of East Asia, openness indeed boosted growth, but also increased the region's susceptibility to external shocks. Second, the Asian crisis was unique in the sense that it stemmed from private sector weaknesses, which, in turn, highlighted poor government regulation and supervision. By eventually addressing these weaknesses, the private sector became stronger and eventually played an important role in both national and regional economic growth and stability. Third, technology permanently altered the size, nature, and speed of capital flows. Observers are in agreement that the huge reversals in capital flows in the months following the collapse of the Thai baht greatly hurt the region's economic stability. Fourth, the paradigm of export-led growth, combined with trade liberalization, was no longer, by itself, enough to sustain progress. It had to be coupled with the development of domestic capital markets, which also involved improving governance and regulation, especially in the financial sector. Fifth, regional cooperation was an increasingly important feature of the region's economic stability.

TABLE 3.2. Pre- and Postcrisis GDP Growth
percent

Country	*1990–96*	*1997*	*1998*
China	10.5	8.8	7.8
Hong Kong, China	4.9	5.1	−5.0
Indonesia	8.0	4.7	−13.1
Japan	2.3	1.9	−1.1
Korea, Rep. of	7.9	4.7	−6.9
Malaysia	9.5	7.3	−7.4
Philippines	2.8	5.2	−0.6
Singapore	8.9	8.5	−0.9
Thailand	8.6	−1.4	−10.5
Average	7.0	5.0	−4.2

Source: World Bank 2005.

Let us take a closer look at how each feature manifested itself.

In the 1970s and the 1980s, the Asian economies tried to be major players in the global economy. Export-oriented growth was the main strategy of the eight so-called tiger economies of Hong Kong, Indonesia, Korea, Japan, Malaysia, Singapore, Taiwan (China), and Thailand. For example, Korea's exports as a share of GDP increased from 13.3 percent to 31.8 percent (see table 3.3). By 1985, the exports of the emerging markets in Southeast Asia exceeded 20 percent of GDP. The establishment of the ASEAN Free Trade Area was a major initiative that ensured the free flow of goods and services in Southeast Asia. Exports and imports flourished as the region embarked on trade liberalization.

TABLE 3.3. Exports as a Share of GDP
percent

Country	*1970*	*1975*	*1980*	*1985*
China	1.8	4.2	7.6	10.0
Hong Kong, China	93.5	83.8	89.1	108.1
Indonesia	13.5	24.0	34.2	22.2
Japan	10.7	12.7	13.6	14.3
Korea, Rep. of	13.3	26.3	31.7	31.8
Malaysia	41.4	43.0	56.7	54.1
Philippines	21.6	21.0	23.6	24.0
Singapore	—	—	—	—
Thailand	15.0	18.4	24.1	23.2

Source: World Bank 2005.
Note: — = no data are available.

East Asia also became a top destination of FDI. Efficiency-seeking multinationals located their operations in these countries, where trade barriers were low and goods could be easily shipped out to other parts of the world. Undoubtedly, economic openness helped advance growth, but, at the same time, it heightened the exposure of individual economies to the risks posed by external factors.

As the growth process unfolded, the East Asian countries became more closely linked with each other, but this development heightened the tendency of fund managers to view the region as a single market. This became strongly evident when, at the collapse of the Thai baht in July 1997, contagion swept through the rest of the economies as fund managers and other foreign investors pulled out funds regionwide despite the individual merits and economic fundamentals of individual countries. The trouble in Thailand spread quickly to Indonesia, Korea, Malaysia, and the Philippines.

This contrasted with experiences prior to the crisis, whereby countries in the region had, at various times, undergone periods of economic difficulty, but with hardly any effect on the regional economy. My country, for example, experienced a severe recession in 1983, which eventually led to a fiscal crisis in 1985. Weak macroeconomic fundamentals and political instability strained the economic and financial systems, but the ramifications did not go beyond the domestic economy.

The Asian financial crisis was particularly surprising to most observers since not only did East Asia exhibit superior economic performance prior to 1997, but the crisis, unlike other financial crises prior to this one (such as the Mexican financial crisis), had its origins in the private rather than the public sector and found its roots in the private banking sector in particular because of a lack of an arm's-length relationship between the banks and their borrowers.

Thus, banks funded risky projects in the absence of more prudent credit processes, and, when some of these projects became unviable, corporations experienced difficulties, and banks were literally left holding the proverbial empty bag that wreaked havoc on their balance sheets. Investors lost confidence, which soon led to reversals in capital flows that strained the financial sector and caused problems in the real economy because of the unprecedented increase in the speed and volume of private capital flows.

Looking back, I observe that there may have been a tendency among many financial analysts to pay less attention to private capital flows, and, thus, they ended up somewhat caught by surprise by the phenomenon, since, historically (up to that point, at least), capital flows had been dominated by bilateral and multilateral fund movements. These movements were gradual because of the lengthy approval processes involved. I myself worked in the World Bank for several years and recall that the period of time between project identification and loan approval was almost invariably nine months, followed by an almost equally lengthy time period for the fulfillment of the conditions before actual loan release. It was a bit of an inside joke among World Bank country officers as I then was that a World Bank loan was rather like pregnancy: no matter how much effort or how many people were involved in the job, it would inevitably take nine months. Not so with the private sector, which included massive treasure chests of pension funds, aided as it was by the rapid and continued development of new technology that allowed the instantaneous transfer of enormous amounts of private capital across countries worldwide without the need for the processing protocols guiding bilateral and multilateral capital flows. Between 1990 and 1996, private flows increased at least threefold in four Southeast Asian economies (see table 3.4), and arbitrage thrived as private firms searched for the best place to park their funds or the place where returns would be the highest.

The Asian financial crisis made it increasingly evident that the paradigms of export-oriented growth and trade liberalization were no longer sufficient to sustain growth; the need for improved financial supervision and the development of domestic capital markets was gaining urgency. The heavy dependence of countries in the region on bank financing was largely due to the lack of alternative financial instruments that more well developed domestic capital markets might have provided. Banks used foreign funds borrowed on a short-term basis to finance long-term projects that did not generate foreign currency. A number of economists cited the double mismatch problem—mismatches in currency and maturity—as another major cause of the crisis.

TABLE 3.4. Net Total Private Capital Flows
current US$ millions

Country	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
Indonesia	2,923.30	3,451.30	4,431.70	411.50	5,973.10	8,141.60	14,882.50
Malaysia	476.30	3,480.43	8,380.17	17,157.60	12,609.07	10,062.99	11,116.82
Philippines	639.20	398.10	(1,102.30)	1,822.40	2,460.80	2,372.30	5,784.30
Thailand	4,370.45	4,990.69	4,736.52	7,110.18	4,606.34	10,016.28	13,320.38

Source: World Bank 2005.
Note: Data are drawn from the World Bank's Debtor Reporting System.

By nature, banks are short-term lenders. Large-scale projects that require long-term financing are best funded by bonds and other instruments, which were not developed in the domestic markets at that time. As a finance minister raising funds in the international market, I had to ask myself many times if this situation jived with the region's high savings. The availability of more regional financial instruments might have better mobilized East Asia's enormous amount of savings in the region; instead, they were being placed in financial markets in the West, which made them susceptible to the herd mentality that manifests itself now and then among global fund managers. This welcome view about financial instruments is now being strongly propounded by, among others, Donald Tsang (more recently in his speech before the Boao Forum for Asia in April 2006).

The features of the crisis shared a common theme: the region's economies had become closely intertwined, and, interestingly enough, as things turned out, the solution to the crisis was in more and not less regional cooperation. In fact, the crisis did not last as long as some sectors expected, partly because of the region's closer economic ties. Prior to the crisis, the region's export orientation targeted the consumers of the American, European, and Japanese markets based on a then prevailing view and experience that a slack in the U.S. economy and, thus, a slack in export demand would usually be taken up by Japan and vice-versa. But, then, when the financial crisis struck, the economies of both Japan and the United States were in the doldrums, and it was growing intraregional trade that served as a buffer for East Asia and saved the day. By 2005, intraregional trade had grown to more than 40 percent of total trade, comparable to that of the North American Free Trade Area (Burton, Tseng, and Kang 2006). Increased intraregional trade helped provide an alternative market for the region's exports, which, in turn, truly helped the East Asian economies get back on track in a shorter period of time than many had anticipated. Clearly, therefore, immediate and long-term solutions to the crisis necessitated a more vigorous pursuit of greater regional cooperation.

In the course of my chairmanship of the Asia-Pacific Economic Cooperation Finance Ministers at the height of the crisis in 1997–98, a number of meetings were held that resulted in the drafting of the Manila Action Plan (or the Manila Framework). Its provisions[1] included the following: (1) the development of regional surveillance to complement global surveillance,

(2) the implementation of technical assistance and support to strengthen the financial sectors of related countries, (3) the call for expanding the resources of the International Monetary Fund to manage future crises, and (4) the establishment of a regional financing arrangement to complement assistance programs of the International Monetary Fund and other international financial institutions. This framework reiterated the importance of a free and open economic environment that was grounded on policy coordination at both the national and regional levels. The Manila Framework paved the way for initiatives in and the strengthening of regional dialogue and the expansion of regional financing facilities.

A significant development in the area of policy dialogue was the coming together of the ASEAN 10+3 economies (the ASEAN countries, plus China, Japan, and Korea). Previously, formal dialogues in ASEAN were limited to the member countries. The crisis brought together the leaders of the ASEAN 10, plus China, Japan, and Korea, to discuss issues such as regional growth and stability. Since 1999, the ASEAN+3 have been meeting to discuss issues such as economic surveillance, financing facilities, and bond market development through the ASEAN+3 framework. These dialogues have formalized the cooperation among ASEAN members and the East Asian countries, giving rise to genuine East Asian cooperation.

The Chiang Mai Initiative, an effort born out of the ASEAN+3 Finance Ministers' Meeting in Chiang Mai, Thailand, in May 2000, was the first regional financing arrangement aimed at assisting countries in managing swings in capital flows and maintaining exchange rate stability. Its aim was to expand the existing ASEAN Swap Arrangement by (1) providing coverage to all ASEAN members, (2) raising the size of the swap arrangements, and (3) creating a network of bilateral swap agreements among the ASEAN+3 economies (Wang and Andersen 2003).

Long-term postcrisis initiatives focus rightly, I believe, on the development of capital markets, including the improvement of regulation and supervision in the financial sector. Efforts to realize the development of local-currency bond markets are now in full swing, led by the Asian Bond Markets Initiative. I think these efforts must be relentlessly pursued to successful completion since, among other effects, bond markets will decrease the region's heavy dependence on banks for financing. Furthermore, East Asia has huge savings; the gross national savings of most countries exceeded 30 percent of GDP from 1993 to 2003. These funds can be better utilized to fund the region's investment needs (for instance, in supporting private sector–led infrastructure development). It is also ironic that most of these savings leave the region essentially only to loop back because Asian firms have had to borrow from Western banks. The development of bond markets can potentially correct this situation (see table 3.5).

There has been considerable progress in developing domestic capital markets. The Asia Cooperation Dialogue has been tasked to draft guidelines for developing sound bond markets in the region. At the Asia Cooperation Dialogue Informal Meeting on Promoting Supply of Asian Bonds, held in Bangkok in May 2004, the representatives of the member countries recognized the need to create a sufficient supply of bonds through the regular issuance of investment-grade local-currency-denominated bonds at different maturities to create benchmark yield curves. In addition, member countries agreed to find ways and means to trade these bonds actively across countries with ample liquidity in the region and the world.[2]

The discussion on developing domestic capital markets has now progressed toward the harmonization of rules and regulations in the bond market. The Asian bond market has enormous potential, given the strong recovery of the region and its huge accumulation of foreign reserves, amounting to more than US$1 trillion. Since bond markets in emerging economies in East Asia are in different stages of development, seven areas must be harmonized to promote the development of regional bond markets. These are the legal and regulatory framework, rating agencies, trading platforms, clearing settlement, accounting and auditing standards, taxation, and foreign exchange regulation.

TABLE 3.5. East Asian Savings as a Share of GDP, 1993–2003
percent

Country	*Gross national savings*
China	41.6
Hong Kong, China	32.6[a]
Indonesia	23.7[b]
Japan	29.4
Korea, Rep. of	34.4
Malaysia	35.6
Philippines	22.2
Singapore	48.9
Thailand	32.2
Vietnam	27.2[c]

Source: World Bank 2005.
a. No data for 1993–97.
b. No data for 2001.
c. No data for 1993–95 and 2003.

At the heart of regional financial reforms is the development of a strong institutional and regulatory policy framework. The financial sector must be able to manage the risks that come with the capital flows and to provide an early warning of impending crisis. It is important that financial institutions across the region are properly supervised. Efforts to strengthen the regulatory and supervisory framework in the region must be complemented by global prudential regulation standards such as Basel II and the international accounting standards. Developing strong regulatory and supervisory frameworks in the individual countries is important for the region's financial stability. There has to be a convergence in the quality of financial institutions if regional cooperation is to work effectively. For one thing, as we saw during the crisis, trouble in one country may cause massive investor panic and quickly spill over to neighboring economies. Thus, it is important that all countries in the region implement reforms aimed at improving their respective financial sectors.

The reforms and initiatives, of course, necessitate greater engagement among the region's individual-country central banks. In fact, the Chiang Mai Initiative is a collaborative effort of the individual central banks. The Executives' Meeting of East Asia–Pacific Central Banks (EMEAP) is a strong anchor of central bank cooperation in the region. It is a caucus of the 11 central banks and monetary authorities of Australia, China, Hong Kong (China), Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, and Thailand. A prominent effort of the EMEAP is the Asian Bond Fund. This fund invests in sovereign and quasi-sovereign bonds issued by EMEAP members (except Australia, Japan, and New Zealand). On the one hand, Asian Bond Fund 1, which was launched in 2003, invests in dollar-denominated bonds, and access is limited to EMEAP central banks. On the other hand, Asian Bond Fund 2, which was introduced in 2005, invests in local-currency-denominated bonds and is accessible to private investors.

While the Asian crisis has, in a way, sealed the case for greater regional financial cooperation, developments in trade and investment in recent years provide a further impetus for such cooperation. As intraregional trade has gained momentum, so has intraindustry trade. Research shows that the automotive, electronics, and health care products industries in ASEAN are now highly integrated. Production processes for goods are broken down into several stages and are located throughout the region depending on the comparative advantage of the host countries. These regional production networks are the strong drivers of FDI, which has become an important source of capital for East Asian economies.

The potential of intraregional trade and investment to be drivers of growth must be harnessed. Achieving this entails stronger financial cooperation in the region since the financing of trade and development requires a developed financial market. For example, regional production networks, which are trade driven, require huge financing. This means that capital markets must be well developed. A regional bond market can help address this need. Intraregional trade, on the other hand, requires exchange rate stability among the participating economies. To some extent, this also necessitates continuing improvements in regional exchange rate coordination.

Given these issues, we have to ask ourselves a number of questions. How far and how rapidly are we going to implement regional financial cooperation? How do we advance from policy dialogue and surveillance to more concrete initiatives? What form of regional financial arrangement best suits us? Are we headed toward the direction of a monetary union? At this point, it is useful to review some of the proposals that have been put forward.[3]

Some posit using the U.S. dollar standard to achieve regional exchange rate stability. The advantage of using a dominant international currency—the U.S. dollar standard is simple and involves no extra cost in ensuring exchange rate stability—is that it is beneficial to the emerging markets in the region. The danger, however, lies in the fluctuations in the effective exchange rates in the face of erratic movements in yen-dollar exchange rates.

Another proposal is to use a currency-basket system whereby a currency's central rate is linked to a basket of major currencies (such as the euro, the Japanese yen, and the U.S. dollar) rather than to one dominant currency (such as the U.S. dollar). This system prevents excessive fluctuations in effective exchange rates in the face of volatile yen-dollar or euro-dollar rate movements, while leaving room for East Asian currencies to move within a certain range. However, monetary authorities must determine the weights for each currency in the basket, and this has to be coordinated throughout the region.

Of course, the possibility of moving toward a common currency area is also on the horizon. A number of studies argue that East Asia is an optimal currency area. However, a sine qua non for monetary integration is to begin the process of economic convergence among the region's economies. This is not an easy task given the diverse levels of income and development in the region. Assuming this is successfully accomplished, then the next step, the introduction of a regional currency unit, can be contemplated. Some have advanced the notion that this can be done by first constructing a basket of regional currencies that includes the 13 currencies of the ASEAN+3 countries. The weights of the regional currencies would reflect the relative importance of the countries in the region. A regional currency unit, thus derived, could be used to denominate economic transactions (trade and capital flows) and asset stocks (foreign exchange reserves and crossborder bonds), as well as to measure the degree of each currency's exchange rate deviation from the regional average. From this point, movement toward a monetary union could be eventually made.

Unfortunately, I believe, it may not be as straightforward as that. Perhaps, as East Asia embarks on greater financial cooperation, it should look at some of the lessons imparted by the experience in the European Union (EU) in this regard. First, the process of arriving at a common currency took the EU states decades, not merely years of adjustment. (It took 50 years for the euro to became a reality. The process of convergence among the EU economies was a long process, given the members' diverse levels of development. Clearly, the levels of development and the differences in culture of East Asian countries are even more diverse.) Second, monetary integration requires strong institutions at both the national and regional levels. A monetary union can only be sustained if countries are sufficiently credible to commit to regional policies. Third, monetary integration requires stronger leadership and policy coordination at the regional level. There has to be strong political will to see the integration through, and, more importantly, one or two countries should clearly take the lead.

East Asia need not and, in fact, should not take the EU model wholesale and use it as a blueprint for the region. However, given these lessons, East Asian economies must address some issues that might affect regional financial cooperation. At the onset, three factors might make the process longer and more difficult than usual. These are (1) income disparities and poverty, (2) inconsistencies in institutional quality and governance across the region, and (3) the lack of solid leadership at the regional level.

Despite decades of stellar economic performance, income disparities remain. Per capita incomes in Hong Kong (China), Singapore, and Taiwan (China) are among the highest worldwide. The region is also home to about 280 million people each living on US$1 a day. The idea that financial cooperation leads to greater economic openness remains unpopular in some sectors. These sentiments ultimately delay the process, as governments find it hard to convince their citizens of the benefits of a regional economy. Conditions look optimistic though. The World Bank reports impressive poverty reduction in the region in 2005. The share of the population living on less than a dollar fell to 8 percent in 2005 from 9 percent in 2004 (World Bank 2006). To make integration more acceptable, the region must strengthen its poverty reduction efforts. Improvements in living standards will make it easier for people to see the benefits of a regional economy.

Another potential impediment to financial cooperation is the poor quality of institutions and governance in some East Asian countries. The role of institutions in the development process has become very important in recent years. Although Hong Kong, Japan, and Singapore are home to high-quality institutions, the rest of the economies in the region are plagued with governance problems. Looking at the corruption perceptions index score in 2005, only four countries garnered a score halfway to a perfect score of 10 (least or virtually no corruption). Singapore scored 9.4, one of the highest scores in the world. In contrast, China, Indonesia, the Philippines, and Vietnam are some of the worst performers in the world (see table 3.6). If East Asia is serious about stronger integration, it must resolve the perceived poor quality of institutions in these countries. High-quality institutions will make the region's efforts more credible and help to fast track financial cooperation.

Lastly, there is a need for clearer leadership at the regional level. At present, policy making in East Asia is consensus based, which has its benefits. However, as the process of integration deepens, such consensus should address the need to reduce tensions between countries with less than friendly relations. Hostile relations hinder effective cooperation and might prolong the integration process. Individual countries must set aside their differences for the common good.

TABLE 3.6. Corruption Perceptions Index, 2005

Country	*Score*
China	3.2
Hong Kong, China	8.3
Indonesia	2.2
Japan	7.3
Korea, Rep. of	5.0
Malaysia	5.1
Philippines	2.5
Singapore	9.4
Thailand	3.8
Vietnam	2.6

Source: Transparency International 2005.

Admittedly, there are other issues equally crucial in realizing closer financial cooperation. The foregoing are, I think, among the more pressing issues that should be addressed.

East Asia's successful recovery from the crisis has made it once again a destination for capital and investment. Of course, it is common knowledge as well that the rapid growth of China has become an irresistible magnet for large investments in the region. China's emergence, seen as a threat in the past, has presented abundant opportunities in the region. China's import spending was estimated at US$413 billion in 2003 and was expected to grow by 30 percent in 2004 (Wattanapruttipaisan 2005). Given this, China is a major buyer of Southeast Asian goods and services. In fact, every Southeast Asian country has a positive and growing trade surplus with China. Another positive observation is that China's exports from ASEAN are composed of high-value goods such as machinery, transportation equipment, and chemical products (Wattanapruttipaisan 2005).

The region's recovery, coupled with the emergence of China, brings a positive economic outlook. China will continue to be an important source of needed stimulus for regional growth as the United States orchestrates a managed soft landing to more healthy fiscal and current account balances. The opportunities and, more importantly, the risks that come with China's progress must be properly managed if the region is to benefit from this phenomenon.

In closing, let me summarize the key points I have raised in this discussion. First, the Asian crisis highlighted five lessons that brought the concept of greater financial cooperation in East Asia to the fore of regional discussion. The crisis emphasized the close link among the region's economies, the growing importance of the economic role of the private sector, the impact of technology in altering the size and speed of capital flows, the need for a new growth paradigm that involves the appropriately sequenced development of domestic capital markets, and the need for greater regional financial cooperation. Second, in the aftermath of the crisis, reforms and initiatives were launched toward the realization of closer financial ties in the region. These included greater engagement among the region's financial and monetary leaders, the expansion of regional financing facilities, and the development of a regional bond market. Third, as East Asia traverses the path of recovery, observers are beginning to ask if we are headed toward the direction of the EU. Is an Asian currency on the horizon? Certainly, this is a question that cannot be answered definitively at the moment because several issues still need to be addressed before the region can embark on the process of a common currency. There has to be greater convergence among the region's economies and institutions; at the same time, there has to be strong leadership at the regional level. I dare say, however, that, at this point, achieving monetary union is not the most pressing issue of the day. What East Asia must instead realize is that establishing the building blocks for a monetary union is as good a goal for the region for now as actual monetary union itself, since these building blocks will lead to greater financial cooperation, which, in turn, promotes regional economic stability.

It took a massive financial crisis for the region to realize more fully the need for stronger financial cooperation and to take more definitive steps in that direction. East Asia has learned its lesson well. Whether we move toward the direction of a monetary union or a different form of financial integration, it is clear that the financial sector can no longer be left out of or play second fiddle in the regional agenda. As the region accelerates its economic growth once more, it needs to ensure the stability of its progress, and stronger regional financial cooperation can definitely serve as East Asia's economic anchor for that process.

Notes

[1] The Web site of Japan's Ministry of Finance (http://www.mof.go.jp) provides detailed information on the provisions of the Manila Framework.
[2] The information provided in this paragraph has been culled from the Asian Bond Market Initiatives Web site, at http://aric.adb.org/asianbond/index.htm.
[3] Some of the proposals on monetary integration presented here are discussed in Kuroda and Kawai (2003).

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