# Asia needs better financial monitoring and safeguards as integration increases

Asian economies and financial systems are becoming ever more integrated, but their monitoring has not kept pace and better safeguards are needed. This is especially true for cross-border issues.

Peter Morgan, co-chair of research at the Asian Development Bank Institute, says that Europe can provide a valuable guide to developing the necessary institutions in Asia.

> Since regional financial integration is most advanced in Europe, its experience should provide valuable lessons (both positive and negative) for Asia. Nonetheless, the levels of economic and financial development and financial integration in Europe and Asia are very different. Asian economies encompass much greater diversity in terms of economic development, institutional capacity, and financial market depth and openness than do European economies. This suggests that the European experience represents an important reference point, but not a template or a benchmark, and that the appropriate level of financial regulatory cooperation and types of regional institutions will differ substantially from those that have developed in Europe.

Morgan notes that past regional and global crises have highlighted the need for better oversight in Asia. Financial and economic integration has now raised the stakes:

> An increasingly financially integrated Asia will need more intensive financial cooperation, including greater efforts to harmonize and coordinate financial supervision and regulation. In particular, greater financial openness increases the potential vulnerability of Asian economies to the vicissitudes of volatile capital flows, underlining the need for regional efforts to improve financial

stability. Increased economic integration as a result of trade liberalization and the development of supply chain networks has also increased the value of policy coordination, including stabilizing intra-regional exchange rates. Finally, a gap has opened up between national regulation efforts and global regulatory cooperation. Establishing a regional regulatory architecture can help to fill that gap.

Morgan explains that Asia needs effective regional bodies to monitor financial markets and capital flows for risks such as sharp movements in capital. Those institutions would also need to coordinate financial sector surveillance and regulation and work with their global counterparts on new regulations, as well as coordinate efforts during times of crisis.

He says that Asia has made more than just a start at forming the sorts of organizations that could evolve into the cross-border monitoring and supervisory bodies that are needed. The Association of Southeast Asian Nations or ASEAN is working toward greater financial openness and regulatory harmonization, for example, although by necessity that is a multi-track process because of varying degrees of financial development.

Along with this, ASEAN economies need to strengthen institutions for regional cooperation to promote regional harmonization of regulations, taxation, and so on, using the ASEAN finance ministers' and central bank governors' surveillance process as the starting point. This is particularly important in view of the great divergence of regulatory performance and capacity within the region. One beneficial step would be to include financial regulators and deposit insurance corporations in at least some deliberations so that the monitoring of regional financial stability could be strengthened.

After the Asian financial crisis in 1997–1998, countries set up an agreement that would allow them to access foreign currencies from each other in times of crisis. That effort, known as the Chiang-Mai Initiative, has evolved into an arrangement whereby Asian countries contribute funds that can be tapped in times of need, much like the International Monetary Fund does globally.

Morgan suggests a number of steps to strengthen this effort, such as adding more countries and increasing the size of the lending pool. He also suggests raising, and ultimately getting rid of, an automatic trigger that forces countries into an IMF program once a certain level of funding has been tapped.

> At the same time, it needs to develop a framework for cooperation with the IMF in the event that a widespread systemic shock occurs involving multiple countries. With these, a de facto Asian monetary fund will have emerged.

The recent past holds several examples that demonstrate the need for Asia to act on better regional financial and regulatory oversight.

> The global financial crisis of 2007–2009 and the subsequent eurozone sovereign debt and banking sector crisis of 2011–2012 added to the urgency for greater financial cooperation by providing reminders of the vulnerability of Asian economies to shocks emanating from the global financial market. Moreover, one of the key lessons of the eurozone crisis is that greater financial market integration requires greater integration of financial regulation and supervision as well.

That was Peter Morgan, co-chair of research at the Asian Development Bank Institute. He wrote Regional Financial Regulation in Asia, a chapter in *Global Shocks and the New Global and Regional Financial Architecture, Asian Perspectives*, a new ADBI book, which he edited with ADBI Dean Naoyuki Yoshino and Pradumna B. Rana of the S. Rajaratnam School of International Studies, Nanyang Technological University, Singapore. This is part four of a four-part series based on the book.

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