7 Regional Financial Cooperation in ASEAN+3: Taking Stock and Moving Forward

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7.1 Introduction

Financial cooperation in the ASEAN+3 region, which was prompted by the experience of the Asian financial crisis in 1997, has deepened considerably in recent decades. Substantial progress has been made in various areas, including the set-up of regional financial safety net arrangements through the Chiang Mai Initiative Multilateralization (CMIM), the establishment of regional surveillance and monitoring frameworks through the ASEAN+3 Macroeconomic Research Office (AMRO), and the implementation of the Asian Bond Markets Initiative (ABMI) to help develop homegrown sources of funding. Over the years, the CMIM has expanded and achieved notable improvements.[1] Along with the stock of foreign exchange reserves and bilateral swap arrangements among economies in the region, the CMIM has turned into a powerful layer of the region's multi-layered financial safety net together with AMRO, a regional surveillance and monitoring system. The ABMI has also facilitated remarkable progress in local currency bond market development, with marked increases in issuance of local currency bonds by member economies, alongside improvements in regional bond market infrastructure, and stronger regulatory cooperation to promote cross-border bond trading.

[1] Since a strong and credible surveillance unit is a critical component of any significant CMIM reforms, the importance of AMRO cannot be overstated. As Grimes and Kring (2021, p. 436) note: "AMRO's development as a capable and independent surveillance and program design unit is a precondition for whatever future CMIM's members are moving toward, whether that future be delinking from the IMF, creating a more equal relationship with the IMF, or simply providing better and more regionally sensitive information to members as they manage their own economies or provide policy feedback to their partners."

The chapters of this volume span the period from the global financial crisis to the onset of COVID-19 and analyze selected aspects of financial cooperation and integration in the region. ASEAN+3 financial cooperation has passed substantial milestones in building regional liquidity support, promoting economic surveillance and policy dialogue, and developing local currency bond markets. However, challenges remain to support the region's growing demand for long-term capital, possibly in areas of infrastructure investment and the pension and insurance sectors to prepare for aging populations. A great deal more needs to be done to bolster regional financial cooperation and mobilize long-term finance, enhance financial resilience, and reinforce regional financial safety net arrangements.

A broad theme emerging from this volume is that while progress in regional financial development and cooperation has generally been substantial, to date it is rather patchy and remains a work in progress.

7.2 Key Insights and Policy Priorities

This chapter draws together some specific messages from other parts of this volume and summarizes their main ideas and policy recommendations. The framework for developing the capital markets in Asia covers strengthened regulatory cooperation across the finance sector and improvements to its capacity to deal with emerging issues such as funding infrastructure for climate change mitigation and navigating the implications of rapid change though technological innovation in fintech. Comparison between different aspects of financial integration and development of regional financial safety nets in Asia versus Europe are included because they offer pointers for future agenda of regional financial cooperation in a coherent manner.

Deepening Local Currency Corporate Bond Markets, Managing Risks to Capital Flow Volatility

While bank-based financial systems still play a dominant role in ASEAN+3, the size of the local currency bond markets as a share of the region's GDP has grown markedly over time. Of some concern is that the local currency bond markets in many regional economies remain largely dominated by government bonds (the Republic of Korea, Malaysia, and Singapore being exceptions), although growth of corporate bond markets has been robust.[2] To support further development of local currency corporate bond markets,

[2] As noted in Chapter 1, there is a clear dichotomy in the region with capital market development in Cambodia, the Lao People's Democratic Republic, and Myanmar lagging by quite a distance.

the ASEAN+3 central banks may have scope to establish a regional repo market which will provide cross-border liquidity to dealers in local currency corporate bonds. Corporate debt markets must also become more accessible to lower-rated issuers to play their appropriate economic role. Hence, the proposed regional repo market should accept lower-rated issues as collateral. To resolve conflict between what is acceptable as repo collateral and what market development requires, ASEAN governments may wish to turn to the Credit Guarantee and Investment Facility (CGIF), which was opened in 2010 by ASEAN+3 countries with ADB assistance. The CGIF offers guarantees for bonds issued by firms facing constraints in obtaining long-term funding from the local bond market. The CGIF could provide enough of a credit guarantee for lower-rated corporate bond issues to be accepted as collateral in a regional repo market. Such a repo market would in turn enhance liquidity of these corporate bonds.

While the internationalization of bond markets in the region has helped keep the cost of funding low, the notable rise in corporate debt and bank loans to firms denominated in US dollars rather than in local currency remains a source of vulnerability for ASEAN+3 economies. The scale of vulnerability depends on the abilities of firms to hedge against the foreign exchange risks using financial instruments. Besides developing foreign exchange derivative markets that allow foreign investors to better manage currency risks, it is important to broaden the domestic bond market investor base since domestic investors may be less exposed to currency valuation risks than foreign counterparts. This would go some way to reduce the "original sin redux" (Carstens and Shin 2019), which may have partly triggered sharp reversals in portfolio flows and the significant credit tightening in emerging economies in the region and elsewhere seen at the beginning of the COVID-19 pandemic and in other times of financial stress.

Nevertheless, greater sophistication in the international financing activities of regional firms tends to obscure the sources of increased external vulnerability, as was outlined in Chapter 1. Rapid financial innovation combined with strong capital flows makes it especially challenging to maintain financial stability. Keeping up with new challenges in this regard is critical for the ASEAN+3 region since it is so open to the forces of financial globalization.[3]

[3] Data from the Bank for International Settlements (BIS) on international debt securities finds that offshore affiliates have been especially important for nonfinancial firms from emerging economies, with firms in the PRC particularly active in using offshore affiliates (usually shell companies based in Hong Kong, China) to issue debt that is held mainly in the Cayman Islands and the British Virgin Islands.

Recognizing and Managing Banking Concentration Risks

While banking systems in regional economies were generally in good shape before the COVID-19 pandemic, concerns remain in some countries that increased nonperforming loans among banks and nonbank financial institutions could give rise to financial distress as central bank support winds down.[4] While nonbank financial institutions play an important role in the global financial system, unlike banks they are not fully supervised. As the nonbank financial sector has grown in size and its interconnectedness with banking systems, the risks related to liquidity, leverage, and market volatility need to be managed. The impact of COVID-19 on credit markets also exposes the risks to financial stability of rising nonperforming loans. The risks can be magnified through financial interconnectedness of the global financial systems and institutions, as well as by weak regulatory features.

Beyond this, the region remains vulnerable to concentration of cross-border borrowing from regional and global banks. Consequently, regional regulatory cooperation should be strengthened to guard against region-wide slow-burn contagion, sparked by a sustained international credit crunch as funding risks concentrate among large banks. One possible solution would be to treat banks involved as regional systemically important banks (R-SIBs).

The R-SIBs designation could be achieved within the ASEAN Banking Integration Framework (ABIF) with the regional subsidiaries of big banks required to hold additional capital buffers. Given the significance of R-SIBs, which hold assets and liabilities in multiple currencies across different jurisdictions, it may be pertinent to explore how cross-border collateral arrangements can be used to help regional institutions deal with liquidity issues. Regionally active banks may face liquidity and collateral pressures in foreign markets while their holdings of eligible collateral may not be sufficient in every market. Cross-border use of collateral may be effective in reducing their liquidity pressures and collateral burdens. These can be alleviated if the region's central banks are allowed to accept foreign collateral denominated in local currencies or local currency bonds. Absent a regional supervisory college, AMRO could expand its mandate to monitor regional risks that might be generated by the activities of systemically

[4] See Ikeda et al. (2021) for a discussion on bank resilience through the pandemic and concerns about impact of credit losses with policy unwinding.

important financial institutions, include both traditional banks and the big tech firms moving into the financial sphere.[5]

To self-protect from the concentration risk of contagion, countries may also be able to more actively use macroprudential measures. An example is the levy on banks' non-core foreign currency liabilities in place in the Republic of Korea since 2011. Such a levy, which could be limited to banks from jurisdictions in the region most likely to cause concentration risks, could be used to lengthen the maturity structure of foreign borrowing. However, given the cross-border spillover effects from the imposition of such measures, they are best conducted through some form of regional coordination.

Reducing US Dollar Dependence

Chapters in this volume highlight concerns about the continued dominance of the US dollar as an invoicing and reserve currency and in external financing. The former is referred to as the Dominant Currency Pricing (DCP) paradigm and the latter as Dominant Currency Financing (DCF) paradigm. In addition—or as a consequence of the DCF and DCP—the US dollar continues to dominate as a reserve and anchor currency, which in turn presents significant challenges to the regional economies, since exchange-rate flexibility has limited capacity to insulate economies from external shocks.[6]

While some regional economies (particularly the PRC, Japan, and Thailand) have taken important steps to internationalize their respective currencies on a *de jure* basis, they have not made significant headway on a *de facto* basis.[7] There are, however, some signs that regional (own and partner) currencies are increasingly being used for trade among ASEAN+3

[5] ADB (2019) goes further and suggests that the mandate of the CMIM be expanded to deal with possible resolution or recapitalization of regional systemically important financial institutions experiencing financial stress.

[6] Of course, a case could be made that limited insulating power from exchange rate flexibility is better than no insulating power by having a fixed exchange rate.

[7] The yuan shows the most potential in terms of becoming an international currency and has made noticeable progress in recent years. An important recent initiative is the creation of the Cross-Border Interbank Payment System (CIPS) which offers clearing and settlements for cross-border yuan transactions. Others have suggested that the introduction of a digital currency (the e-yuan) may offer a fillip for the yuan's internationalization. All said, the PRC faces multiple challenges in this regard given the stop-start approach toward capital account and financial market opening and deepening and rather limited adjustments in its monetary policy regime (Chapter 3 includes a discussion of the Monetary Trilemma in the case of the PRC). While reform of the foreign exchange regime seems to be firmly on the country's agenda, its pace and timing appears to have been affected by the intermittent shocks (such as the global financial crisis, sharp capital outflows in mid-2014 to mid-2016 and the COVID-19 pandemic).

economies and with the European Union. Policy actions could help nudge this trend forward.

The Local Currency Settlement Framework (LCSF), pioneered by Malaysia, Thailand, and Indonesia, is noteworthy in its aim to substitute the US dollar with local currencies for trade and investment settlements among the three countries. It essentially helps relax domestic foreign exchange rules relating to the offshore use of currencies for international trade and foreign direct investment by providing mechanisms for appointed commercial banks to trade currencies directly and offer financial services in partner currencies. As the framework is expanded to include more regional transactions (such as local currency bonds) and economies, transactions costs in direct exchanges of local currencies are expected to fall below those used to triangulate transactions involving the US dollar.

Beyond the LCSF, further liberalization and coordination of rules and regulations relating to cross-border settlement practices is needed. Scope may exist to revisit the creation of a regional exchange rate surveillance process, using a regional basket of currencies like the ASEAN+3 currency unit (ACU) as a reference indicator, which could encourage coordination on exchange-rate policies and lead to more stable intraregional exchange rates. Greater exchange-rate stability among the regional economies could make it less costly to use local currencies for trade, investment, and financial transactions.[8]

While reducing the region's US dollar dependence must remain an objective for the medium to long terms, the immediate aim should be to develop a region-specific integrated policy framework that promotes macro-financial stabilization in a US-dollar-dominated financial system. Many regional economies need the conceptual guidance. To date, they have tried to manage their economies amid large and volatile international capital flows through some combination of partial exchange rate flexibility, sterilized foreign exchange intervention, and active use of macroprudential and capital flow management measures. The massive accumulation of foreign currency reserves across economies in the region offers a strong buffer against capital flows and foreign exchange rate volatility given the dominance of the US dollar. However, it is not without significant economic cost. Besides the CMIM, use of cross-border collateralization and regional

[8] Some have suggested that the time may be ripe for the region to consider creating an Asian digital common currency as an electronic medium to reduce the US dollar dominance (Inui, Takahashi, and Ishida 2020). While this may be premature, the issue of central bank digital currency (CBDC) is discussed briefly in the next subsection.

currency swap arrangements with pooled reserves could reduce the risk of acute foreign liquidity shortage and cross-border funding pressure in times of financial turmoil. AMRO may be well placed to take this discussion forward.

Fintech Challenges and Opportunities

While the more conventional forms of finance (traditional banks and capital markets) remain highly relevant, the rapid rise of fintech globally and among ASEAN+3 economies cannot be ignored, given the implications for financial inclusion and financial stability.

The COVID-19 pandemic and the accompanying social distancing and lockdowns have accelerated the shift toward fintech activities, which can be broadly divided into five major categories of financial services (FSB 2017). These are (i) payments, clearing, and settlement; (ii) deposits, lending and capital raising; (iii) insurance; (iv) investment management; and (v) market support. The focus of this volume is on the first two categories. The first includes digital advances, point-of-sale technologies, mobile money, cryptoassets, and remittance services, while the second includes borrowing or capital raising though broadly alternative finance, such as crowdfunding, peer-to-peer (P2P) lending, online balance sheet lending, and invoice and supply chain finance.

Fintech can offer significant benefits in greater efficiency, transparency, convenience, and enhancing financial inclusion. That said, such benefits are not automatic, and in many cases early adopters tend to be urban, financially literate, and well educated, with the new technology producing no discernible improvement in financial access for those most in need. The expansion of fintech may therefore give rise to greater inequities between genders; urban versus rural dwellers; larger firms versus micro, small, and medium-sized enterprises; and the like. The promotion of financial literacy and using fintech to encourage financial inclusion will be imperative.

As with any type of financial liberalization and innovation, if not properly harnessed, fintech activities could be accompanied by significant risks in financial stability at both the microfinancial and macrofinancial levels. Of particular concern is the development of P2P lending as possibly damaging the banking system by reducing both deposits and loans, as well as the rise of private digital currencies which could destabilize the flow of credit domestically and reduce the effectiveness of conventional monetary policy tools. There is much scope for learning and sharing experiences across countries in the region, given that they are all impacted by these challenges.

There is also a need to balance the benefits of financial innovation with possible costs concerning financial stability, consumer protection, cybersecurity, privacy and data protection, and anti-money laundering/counterterrorist financing (AML/CFT). These areas require greater regional and international cooperation in the development of legal, regulatory, and supervisory frameworks; monitoring capital flows; harmonizing of standards; and better sharing of data. Some of these issues could be dealt with among regional institutions, including AMRO, ASEAN, and the ASEAN+3 finance ministers and central bank governors' meetings, and other finance forums and working committees within ASEAN.

Fintech innovations backed by established firms pose particular challenges. Regulators need to recalibrate their policy frameworks to better equip themselves to deal with specific types of systemic and contagion risks from the interconnected activities of bigtech firms across multiple sectors in various jurisdictions (BIS 2019; Crisanto, Ehrentraud, and Fabian 2021). The scope and definition of R-SIBs should be expanded to include bigtechs entering the finance space. In some regional economies, the role of bigtechs in financial services is expanding and they are becoming increasingly important for the broader region. In this context, it is pertinent that discussion about how bigtech firms are treated in relation to R-SIBs can pave the way for cross-border regulatory practices to manage risks related to such entities.

Given the challenges posed by private digital currencies, many economies in the region are also looking to create central bank digital currencies (CBDCs), with the PRC taking the lead. It is plausible that CBDCs may lead to an increased use of local currencies in general, though ASEAN+3 economies do not share the same degree of interest in such a project. That noted, there may be scope for regional cooperation with the focus on using CBDCs to reduce the cost of cross-border foreign exchange transactions and increase transparency. Given that development of CBDCs among most central banks in the region is still in its infancy even as it is progressing quite rapidly in some instances, cross-border considerations could promote interoperability among payments systems and so reduce transactions costs (Auer, Haene, and Holden 2021). There are positive signs in this regard. For instance, several regional economies (the PRC; Hong Kong, China; and Thailand) are taking part (along with the United Arab Emirates) in a cross-border digital currency payments project called the Multiple CBDC (m-CBDC) bridge, with support from the BIS. The aim is to explore the application of wholesale CBDCs for multicurrency cross-border payments using blockchain technology.[9]

Financing Sustainable Infrastructure Investments

Despite significant improvements in infrastructure development, the region's financing gap remains extremely wide, especially if climate mitigation and adaptation are included in needs estimates. To the extent that the COVID-19 pandemic has exacerbated fiscal sustainability concerns, innovative ways need to be developed for both the public and private sectors to contribute to overcoming the infrastructure deficit and help fund environment-friendly infrastructure.

One promising method for governments to finance infrastructure is through land value capture, i.e., raising revenues through taxes when land values rise because public infrastructure has been upgraded. While land value capture may be suited to some types of projects, even with this potential source of fiscal revenue, the public sector may not be able to close the infrastructure gap in any significant way without compromising fiscal sustainability.

It is also critical to better incentivize the private sector to support infrastructure projects. Despite much initial enthusiasm for public–private partnerships (PPPs) and related mechanisms that include the private sector in infrastructure financing, results to date have been disappointing. Part of the reason has to do with concerns relating to project riskiness (governance, macroeconomic, and political) and high capital costs. Regional and multilateral development banks could play more active roles in promoting credit enhancement products to reduce the risk gap that has prevented the takeoff of PPP projects in the region.

Floating-interest-rate infrastructure bonds may be a possible way of raising private finance in infrastructure projects through offering higher rates of return. The return on investment will be dependent on tax revenues

[9] See BIS (2021a) for the details. In parallel to this, other countries in the region have also been actively exploring the use of wholesale CBDCs for cross-border transactions including Singapore and Canada who have already successfully tested cross-border and cross-currency payments using wholesale CBDCs (Bank of Canada, Monetary Authority of Singapore, Accenture, and J.P. Morgan 2019). In addition, the BIS is working with central banks from Australia, Malaysia, Singapore, and South Africa to test the use of CBDCs for cross-border settlements–the so called Project Dunbar (BIS 2021b).

collected through the economic activity that development of surrounding infrastructure spurs on. Regional cooperation is needed to support establishment of a regional floating-interest-rate bond in cases where the spillover effects of tax revenues from an infrastructure project extend across country borders, such as for water transport infrastructure along the Mekong River.

The rapid rise of climate change impacts and hazards requires that much greater attention is paid to the use of renewable energy and low-carbon infrastructure. However, mobilization of private finance for this remains an acute challenge in the region, the recent surge in interest in green bonds notwithstanding. There remain concerns about greenwashing (false information about environmental benefits) and lack of generally accepted standards about what constitutes environmental, social, and governance (ESG) investment. While several standard-setting bodies and international organizations have undertaken research and brainstormed policy responses to tackle the macroeconomic and financial risks emanating from climate change,[10] regional cooperation may have a role in developing standards and other measures to facilitate the development of ESG bonds in the region and particularly to help promote green finance. Scope may exist for creating regional consistency on carbon taxes to reduce any regional distortions.

Managing the Financial Sustainability of Pensions

An important structural issue for many ASEAN+3 economies is that the rapid aging of their populations carries significant implications, especially over the sustainability of pensions. Concerns are especially stark in the PRC and the higher-income economies of Japan, the Republic of Korea, Singapore, and Thailand, old-age dependency ratios are rising sharply.

Despite the scale of pension coverage and sustainability as an issue, there appears to have been little discussion about it at the regional level. This is concerning from the perspectives of social welfare and macroeconomics as unsustainable pensions and rising contingent retirement liabilities might spark fiscal crisis in one country with effects that spill over to neighbors.

[10] Examples of such bodies include the Network of Central Banks and Financial Supervisors for Greening the Financial System (NGFS) consisting of over 90 members; the industry-led Taskforce on Climate-related Financial Disclosures (TCFD) and Taskforce on Climate-related Financial Risks (TCFR) constituted by the Basel Committee for Banking Supervision; and the Group of 20 Sustainable Finance Working Group, recently relaunched under the joint chairmanship of the US and the PRC. See Cheng, Gupta, and Rajan (2021) for a discussion on central banks and green finance.

On a positive note, pension funds with large assets under management are a potential source of demand that could facilitate development of local currency bonds. They should be especially welcome given their long-term investment outlooks. Indeed, greater regional investments with a longer time horizon could help alleviate the "original sin redux" problem previously discussed. In a low-interest-rate environment, pensions may need to seek higher yields by investing in assets such as private equity, real estate, and infrastructure. However, regional pensions funds have remained conservative and underinvested in these areas, especially infrastructure. Even if shovel-ready regional projects were available, use of pension funds for infrastructure investment is often restricted by regulations and institutional mandates. It is therefore important that regulations be made more flexible, and mandates of asset managers of pension funds be sufficiently broadened to incentivize long-term funds to invest in infrastructure along with 'alternative assets' offering higher returns—failing which some regional pension systems may not be able to meet their liabilities to retirees. However, given the riskiness of such investments, regional asset managers and institutional investors first need more expertise and domain knowledge. Greater regional dialogue is needed on the lifting of investment restrictions and sharing of best practices on alternative assets.

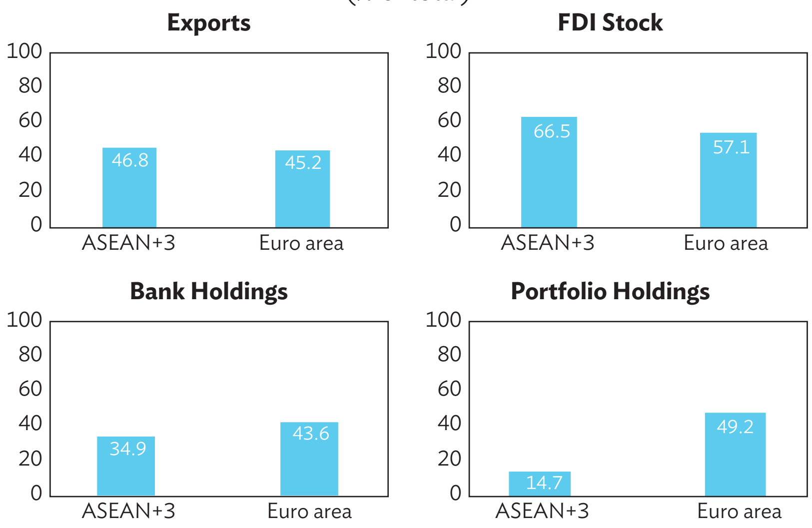
Given the growing mobility of labor, regional economies should also explore bilateral social security agreements to ensure portability of pensions as a second-best option, given that a regional agreement on the issue is most likely to be complicated. Given the rise of non-standard employment, social protection systems need to be redesigned to be future-ready and meet the needs of workers in the gig economy.

7.3 Financial Integration and Regional Safety Nets: Asia and Europe Compared

Given increasing financial interconnectedness in the global and regional financial systems and institutions, it is essential that international financial cooperation is leveraged to manage risks to financial intermediation that might disrupt flows of capital from savers to investors. A clear message that resonates from this volume is the growing financial interconnectedness among regional economies and consequent financial spillover effects, either through large banks with assets and liabilities across multiple jurisdictions, or via capital markets. New challenges have emerged from the rapid rise of fintech and need to fund climate-resilient infrastructure, while ongoing structural challenges posed by rapid population aging persist. Similar issues are apparent in other regions, most notably western Europe.

It is worthwhile to compare and contrast the progress of financial integration and development of regional financial safety net arrangements in ASEAN+3 and the euro area, partly given the fact that both have comparable degrees of regional economic integration through strong intraregional trade and foreign direct investment flows over the last few decades. In 2020, more than 45% of all euro area exports were intraregional, while the corresponding share in ASEAN+3 was a similar 47% (Figure 7.1a). The intraregional share of foreign direct investment stocks is much higher in ASEAN+3, at about 66.5% compared to 57.1% in the euro area (Figure 7.1b). However, the intraregional share in bank flows and portfolio holdings is larger in the euro area than in ASEAN+3 (Figures 7.1c and 7.1d).

Figure 7.1: Intraregional Shares, 2020—ASEAN+3 versus Euro Area
(% of total)



FDI = foreign direct investment
Note: The data are as of June 2020 for portfolio holdings and 2019 for FDI stock. ASEAN+3 includes Hong Kong, China.
Source: ADB calculations using data from (i) Exports: International Monetary Fund (IMF). Direction of Trade Database (accessed April 2021); (ii) FDI stock: International Monetary Fund (IMF) Coordinated Direct Investment Survey (accessed August 2021); (iii) Bank holdings: Bank for International Settlements. Locational Banking Statistics. (accessed May 2021). Asia Regional Integration Center (ARIC). Integration Indicators Database (accessed May 2021); and (iv) Portfolio Holdings: International Monetary Fund. Coordinated Portfolio Investment Survey (accessed March 2021).

Yet, the progress of financial integration, especially in the form of the institutional framework, differs substantially between the two regions. After the sharp currency devaluations of the Asian financial crisis, there was much discussion among ASEAN+3 on the feasibility of the regional economies or a subset of them adopting a common currency, largely given that the introduction of the euro in 1999 went quite smoothly (Fabella 2002). The acute difficulties faced by several countries during the European sovereign debt crisis of 2009–2012, on one hand, and Asia's relatively quick rebound from the global financial crisis, on the other, shifted the debate from the possibility of a monetary union to a comparison of regional monetary facilities.

Table 7.1 illustrates the differences between the characteristics of CMIM and the European Stability Mechanism (ESM). At a broad level, as with the ESM, while the CMIM is meant to offer financial assistance to member economies with financial difficulties, its design differs crucially in some important respects. The CMIM is not protected by international treaty and the resources at its disposal are not transferred to it by member economies unless an economy makes a financing request. However, the ESM is an independent international institution endowed with "paid-in capital" from member states and the ability to raise money from financial markets. This enables it to act swiftly and autonomously during crisis situations (Hyun and Paradise 2019). Further, while the CMIM has only two lending instruments for countries in financial distress (crisis prevention and crisis resolution facilities), the ESM also provides for bank recapitalization and capital market intervention besides loans and credit lines to member states during episodes of financial volatility and turmoil (ADB 2019).

An important area in which the CMIM can learn from Europe is the operationalization of collaboration and cooperation with international organizations during economic and financial crises. For instance, the role of the International Monetary Fund (IMF) is written into the legal provisions of the ESM, which clearly delineate respective roles and approaches in case of joint financing, from a country submitting a financing request and the subsequent disbursal of aid and conditions the recipient must meet, followed by surveillance of the country during the repayment period.[11] Under the ESM, a euro area member country that requests financial

[11] While the ESM has its own Early Warning System (EWS), surveillance is carried out by the European Commission in conjunction with the European Central Bank (Zoppè and Dias 2019). On the other hand, AMRO as a regional institution created to support implementation of the CMIM undertakes surveillance for the ASEAN+3 economies on its own.

assistance is generally expected to make a similar request to the IMF (Henning 2017).[12]

Table 7.1: Comparing the Main Elements of CMIM and ESM

Features	CMIM	ESM
Establishment	Established in March 2010, replacing the Chiang Mai Initiative, which was established in May 2000	Inaugurated in October 2012, following the European Financial Stability Facility, established in June 2010 as a temporary backstop in response to the European debt crisis
Members	All 13 ASEAN+3 member economies and Hong Kong, China	All euro area member countries
Objectives	(i) Address balance of payments and short-term liquidity difficulties in the ASEAN+3 region; and (ii) supplement international financing arrangements	Help euro area member countries undergoing severe financial distress
Type	Multilateral currency swap arrangement	Fund
Financial capacity	$240 billion swap arrangement	Capital: €700 billion (€80 billion paid-in, €620 billion callable capital)
Lending capacity	$240 billion (€218 billion)	€500 billion ($551 billion)
Lending instruments	(i) Crisis prevention facility	(i) Loans within macroeconomic adjustment program
	(ii) Crisis resolution facility	(ii) Primary and secondary market purchases
		(iii) Precautionary credit line
		(iv) Loans for indirect and direct recapitalization of financial institutions
		(v) Pandemic crisis support
Governance and decision-making	A request for activation of swap transactions can be submitted to the CMIM Coordinating Countries	Most important decisions, including those on granting financial assistance to member states, are made by mutual agreement by the ESM board of governors (19 finance ministers and EC and ECB as observers).
	(2 chairpersons—1 from ASEAN, 1 from plus-3 countries) and subject to approval of the Executive Level Decision Making Body.	
Conditionalities	(i) IMF de-linked portion: 40% of maximum drawable amount	For a number of support mechanisms, financial assistance is linked to policy conditions specified in a memorandum of understanding between beneficiary member state and the EC, ECB, and the IMF

continued on next page

[12] Also see Volume 1 for a discussion on possible reforms to CMIM and AMRO.

Table 7.1 (continued)

	(ii) Portion linked to IMF conditionalities: 60%	
Surveillance	Yes, through AMRO	Only countries with financial assistance
Usage	Never been used	(i) Loans within a macroeconomic adjustment program: Greece (EFSF, ESM), Cyprus (ESM), Portugal (EFSF), Ireland (EFSF)
		(ii) Loans for indirect bank capitalization: Spain (ESM)
		(iii) All other instruments have not been used.

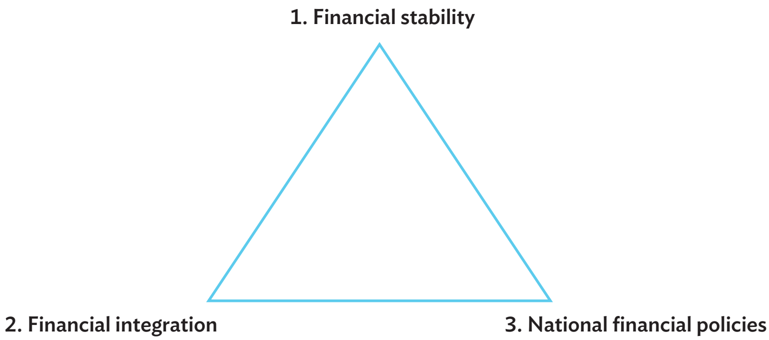
AMRO = ASEAN+3 Macroeconomic Office; ASEAN+3 = Association of Southeast Asian Nations plus the People's Republic of China, Japan, and the Republic of Korea; CMIM = Chiang Mai Initiative Multilateralization; EC = European Commission; ECB = European Central Bank; EFSF = European Financial Stability Facility; ESM = European Stability Mechanism; IMF = International Monetary Fund.
Source: ADB (2019); AMRO and the CMIM (accessed September 2021); ESM Explainers (accessed September 2021); and ESM History (accessed September 2021).

Beyond exchange rate regimes and regional financing facilities, another interesting area is the contrasting approaches to financial regionalism. Conceptually, a useful starting point is the Financial Trilemma framework (Figure 7.2; Schoenmaker 2013).[13] Under the framework, a country can, at any time, only attain two of three objectives: financial integration/openness, financial stability, and national financial policies (i.e., financial autonomy). Consider a situation where a country that maintains financial openness by allowing foreign banks to freely enter chooses to tighten loan-to-value ratios to curb domestic credit. If domestic borrowers have the option of taking out cross-border loans or get funding from the domestic branch of the foreign banks, this could compromise financial stability. To maintain financial stability, the country must be prepared to either limit financial integration or forsake autonomy over national financial policies in favor of harmonized regulations. This is where Europe differs from Asia.

At one end of the spectrum, driven by the experience of the sovereign debt crisis, euro area economies have been discussing the possibility of creating a banking union since 2012. The union would be founded on three pillars: the single-supervisory mechanism, the single-resolution mechanism, and a single-deposit insurance scheme. While progress has been made on the first two pillars, the European Deposit Insurance Scheme (EDIS) remains under discussion, given political economy concerns over the complete

[13] This contrasts with the more well-known monetary trilemma which states that if a country maintains a fully open capital account, it must forsake either complete monetary policy autonomy or complete exchange rate fixity. Monetary trilemma for ASEAN+3 economies is discussed in Chapter 3 of this volume.

Figure 7.2: The Trilemma of Financial Stability



Source: Schoenmaker (2011, 2013).

mutualization of national deposit insurance schemes. While a banking union remains a work in progress, regional economies in Europe have nonetheless gone a long way in being willing to forsake autonomy over national financial oversight. Three European independent supervisory authorities have been established over the years to oversee banks, capital markets, and insurers.[14]

In sharp contrast, while the Asian financial crisis did help shape the decision to create the CMIM, the limited impact of financial crises since then has reduced the urgency of moving toward a region-wide integrated banking union. To be sure, while the ASEAN+3 economies have generally accepted the broad set of standards established by the Basel frameworks, they have chosen to maintain financial policy autonomy as a means to ensuring financial stability. This, in turn, has implied that the regional economies have forsaken a degree of financial integration in limiting foreign bank entry; for instance, through requiring foreign banks to locally incorporate as standalone domestic banks and so effectively ring-fencing the domestic banking system, or by levying macroprudential regulations on foreign borrowing (as the Republic of Korea did in 2011) or as in Singapore imposing different stamp duties to moderate foreign purchases of property (Rajan, Robinson, and Lim 2021). More broadly, such concerns have kept

[14] These include the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority. The European Union (EU) also established the European Systemic Risk Board in 2010 to oversee the EU-wide financial system and address macro-financial risks of the region.

the region's financial markets and systems fragmented and have limited private risk-sharing channels.

While an ASEAN+3-wide banking framework does not exist, governors of the 10 ASEAN central banks ratified an ASEAN Banking Integration Framework (ABIF) in December 2014.[15] While the stated aim of the framework is to facilitate the creation of an ASEAN Single Market in the regional banking sector (i.e., equal access and treatment), the ABIF's scope is rather modest, providing ASEAN countries a way to enter reciprocal bilateral arrangements that give Qualified ASEAN Banks greater market access and operational flexibilities. Countries negotiate bilaterally, with the focus being on reciprocal arrangements that boost financial stability.

Progress on banking and overall financial market integration in ASEAN and the wider East Asian region will remain limited if countries are unwilling to harmonize national regulations, let alone create a supernational regulatory body, as it compromises national financial sovereignty. Heterogeneity in development, capacities, and ambitions across countries makes the prospect of fully integrated financial markets unlikely any time soon, though it is a useful vision that can continue to guide policy priorities. That said, greater cross-border banking activity is already taking place and can be expected to grow with the emergence of regional digital banks and other fintech firms. While many central banks have taken steps to monitor and manage some of these risks, far greater pressures on the governments to harmonize financial regulations are inevitable, since without it the region might be left vulnerable to acute systemic risks. A systemic risk highlighted in Europe is the vicious feedback loop between banking and sovereign debt crises (Acharya, Drechsler, and Schnabl 2014; Brunnermeier et al. 2016). For ASEAN+3 region, this volume has highlighted risks from the rising role of regional systemically important financial institutions in cross-border banking flows. Failure of any of these institutions could undermine regional financial stability significantly, and so requires closer regional monitoring.

[15] This is part of a wider ASEAN Financial Integration Framework (AFIF) endorsed by ASEAN Finance Ministers in 2011, which envisages greater capital market and insurance integration, and aims to liberalize the flow of capital across the ASEAN region, harmonize payments and settlements systems, and strengthen regional financial and surveillance arrangements.

7.4 Conclusion

The COVID-19 pandemic has once again made growing interdependence, the spillover effects of actions, and the need for closer cooperation apparent in view of the high degree of economic and financial interconnectedness in the region. On the trade front, countries reaffirmed their commitment to global free trade and investment in general and vigorously negotiated the Regional Comprehensive Economic Partnership. ASEAN economies, in particular, have also remained steadfast in their support for the ASEAN Single Window to promote seamless intraregional trade, while remaining committed to the ASEAN Digital Integration Framework Action Plan.[16] While room for improvement exists for coordinated financial action, progress in nurturing regional cooperation that promotes financial stability and resilience has been significant over the past two decades.

Moving forward, ASEAN+3 regional financial cooperation should focus more on a specific agenda with vision and goals to further develop regional capital markets for long-term finance, strengthen cross-border market infrastructure, improve regulatory cooperation, and tackle emerging issues such as financing climate change mitigation and the rapid rise of fintech in general and of bigtech firms in finance. Part of this is managing cross-border risks and enhancing crisis surveillance. A clear long-term vision is essential for navigating the path of regional financial cooperation to achieve substantial results along agreed milestones of necessary reforms. More substantively, there may be scope to establish a regional forum for financial development and stability, co-hosted by ADB and AMRO, to make progress on issues raised in this volume.

[16] These initiatives broadly come under the umbrella of the ASEAN Economic Community Blueprint 2025 laid out in 2015 (ASEAN Secretariat 2015).

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