

Work Program for the PECC Finance Forum for 2004

Preliminary for Final Comments : January 27, 2004

I. The Objective and Overview

Launched in 2002, the PECC Finance Forum holds a Conference annually to review the preliminary outputs from its own annual work program. For the record of its work, please visit the website <www.pecc.org/finance>.

The objective of the work program of the PECC Finance Forum for 2004 will be two-fold: first, to prepare input for the 11th annual APEC Finance Ministers' Meeting (FMM) to be held in Santiago, Chile, on September 2-3, 2004, and second, to launch a preparatory work for its report to the 16th bi-annual PECC General Meeting to be held in Korea, in late 2005, alongside the 13th APEC Economic Leaders' Meeting. The two-dimensional aspect of the objective reflects the fact that, as an arm of the PECC, the Finance Forum operates on the two-year cycle as does the PECC itself, and that the year, 2004, will constitute the first half of this PECC work cycle.

In order to be able to produce an output of maximum relevance to the FMM, the Forum proposes to hold its 3rd Annual Conference in Santiago, Chile, on June 21 (Monday) - 22, 2004, preceded by a welcome reception on June 20. This will enable representatives of the Forum to move on to participate in the 18th APEC Finance Ministers Technical Working Group (TWG) meeting to be held in Arica, Chile, on June 23-25. Arica is a 2-hours' flight away from Santiago. This will also enable the Forum to draw participants from among the finance officials participating in TWG to its own Conference.

In response to the proposal submitted by the Forum Coordinator to make a major contribution to the FMM, with endorsement by the members of the Group, Mr. Raúl E. Sáez, Chairman of the TWG and the International Affairs Coordinator of the Chilean Ministry of Finance, was kind enough to warmly welcome and invite the

Forum to do so in the manner of the contribution it made to the Finance Ministers Process in 2003, including actively participating in both the June meeting of TWG and the FMM to be held in September. On behalf of the TWG, Mr. Sáez kindly expressed appreciation of the contribution made by the Finance Forum in 2003.

Likewise, under the Chairmanship of Mr. Manfred Wilhelmy, the Chile PECC has expressed a very strong support for the Forum Coordinator's proposal to collaborate with the TWG as well as for the proposal to hold the 2004 Conference of the Forum in Chile, back-to-back with the TWG meeting, and has graciously agreed to help the Forum convene the Conference in Santiago by serving as the local host. Chile PECC has designated Dr. Sergio Lehmann, Head of the International Analysis and Financial Operations, Central Bank of Chile, as the local Co-Coordinator for the Conference program as well as the Chilean member of the International Advisory Group for the Finance Forum, also designating Mr. Manfred Wilhelmy, Executive Secretary, and Miss Fernanda Hurtado, Program Coordinator, both of the Chile Pacific Foundation (Chairman: Mr. Hernán Somerville) as the local Co-Coordiators for the organization of the Conference.

The theme of the Forum's work for its 2004-2005 cycle will be rather broadly set as *Vision and Roadmap for Financial and Monetary Cooperation in the APEC Region*. However, the Forum will adopt as its sub-theme for 2004, *Institution Building in a World of Free and Volatile Capital Flows: PECC Perspectives*. This amounts to adoption of one of FMM's two themes for 2004, i.e., *Institution Building in a World of Free and Volatile Capital Flows: Looking Forward to APEC 2020*, the other theme being *Fiscal Policies for Growth and Stability in an Open APEC Region*. The Finance Forum thus adopts one of FMM's themes as its own in order to pursue its primary objective of contributing to the Finance Ministers' deliberations. It will, however, have to make sure that its work program will be complementary to TWG's work program, instead of overlapping.

II. APEC Work Program on the Theme¹

The Issues

According to the Bogor goals, by 2010/2020, trade and capital flows among the developed and developing economies of the APEC region will be free. Reaching such a goal and sustaining it over time will require that open markets contribute to, or at least do not hinder, economic growth and domestic financial stability. However, net capital flows to emerging market economies continue to be volatile. As a result, there have been occurring sudden and large reversals of those flows. The consequences of such reversals in capital flows for some APEC economies are well-known. In spite of good fundamentals, emerging economies are forced into what Caballero² has called “precautionary recessions” as access to international capital markets dry up and policy-makers attempt to avoid a full-blown crisis.

APEC economies should try to develop the necessary instruments, both domestic and international, that will help minimize the negative effects of such volatility. In this regard, there are two parallel and mutually complementary levels of action.

At the domestic level, emerging economies should reinforce the regulation of their financial systems in order to keep track of, for example, currency-mismatches between liabilities and assets of financial and non-financial agents, develop early warning signs of stress in the domestic financial system, or accumulate large stocks of international reserves.

At the international level, what is relevant is not only the “traditional” discussion of reforming the international financial architecture, but also to seriously address the creation of mechanisms or instruments that would provide countries with liquidity in time of distress. Providing such liquidity directly has been a role of the

¹ Adopted from the proposal presented by the Chilean delegation to the 17th TWG meeting held in Puerto Varas, Chile, on December 3-5, 2003. Visit www.fmmapec2004.cl for the original TWG document.

² Caballero, R. (2003), “The Future of the IMF”, *American Economic Review: Papers and Proceedings*, Vol.93, No.2, May.

IFIs. The IMF's Contingent Credit Line (CCL) has been one such mechanism newly created but has expired out and no alternative has been proposed. Some market-friendly proposals have been put forward in academic circles. Those proposals would still need the support of IFIs if they were to be put into operation.

At both levels, the emphasis of this theme will be on crisis prevention and not on crisis resolution.

The APEC Work Program

The proposed work program for the 2004 Finance Ministers Process under the present theme will consist of three parts :

- 1) Preparation of a paper by the IMF on the effects of capital flows on macroeconomic stability from an economic policy perspective, with a focus on the requirements for an open capital account, what kind of restrictions are preferable during the transition period, how should a strategy of gradual opening and lifting of restrictions be structured, including aspects such as sequencing, options for the mix of monetary, fiscal and exchange-rate policies, etc.

- 2) Preparation of case studies by member economies on domestic measures taken to shield their economies and financial systems against the effects of capital flow reversals, focusing on domestic policy challenges in order to reduce vulnerabilities to volatile capital flows. Thus, these case studies will examine individual experiences in building domestic institutions adequate in a world of free and volatile capital flows. The papers could discuss key mechanisms that help economies deal with volatile capital flows, what policy initiatives have contributed to the development of these mechanisms, and how these initiatives have interacted or should interact with the opening of capital accounts. They could also identify and discuss current challenges. Specifically, it is suggested that these case study papers address :

- *the macroeconomic policy framework, with focus on the country's monetary and exchange-rate policy framework*, addressing such specific issues as how this framework is perceived to contribute to dealing with volatile capital flows, and support/prevent having an open capital account, the factors considered in the decision on the level of international reserves, etc;
 - *financial sector development, regulation, and monitoring*, examining the development of domestic financial markets such as the derivatives markets and the local bond markets, considered important for improving the resilience of the economy to withstand volatility in capital flows, highlighting the role of the policy authorities in this development, reporting on how countries regulate capital account transactions in regard to the problem of current mismatches, and how the government monitors the systemic stability of the financial sector, and more generally, of the financial stability of the economy as a whole;
 - *capital account opening*, discussing the evolution of policies that have been implemented in this regard, and how policy changes have been sequenced and interacted with other macroeconomic and financial sector policies, addressing specific issues such as the extent to which the opening of the capital account has been affected by, or has affected, the changes in the monetary and exchange-rate policy framework, the extent to which the authorities perceive or have perceived the capital-account opening as requiring a significant improvement in the quality of regulation, and the approach taken to the treatment of capital movements in trade and other international economic agreements.
- 3) A paper, to be commissioned to one or more academics, on new possible international mechanisms for liquidity provision to confront adverse

shocks that would also serve as incentives for good national policies, much in the spirit of the IMF's CCL, exploring the room for possible modifications to existing international facilities and/or eventual creation of new facilities, for example, in the form of insurance-type and hedging instruments such as those proposed by Caballero (*op. cit.*).

III. The PECC Work Program

When presented with a list of topics which the Finance Forum may choose to address under its work program for 2004, the TWG expressed its special interest to hear reports on the following two *among the several candidate topics listed by the Forum Coordinator* :

- *Issues and challenges of the international financial architecture from the Asia-Pacific perspective; and*
- *Financial-sector capacity-building measures (in such areas as risk-management in the banking and the non-bank financial sector, domestic and regional bond market development, and promotion of the venture capital).*

The Forum proposes to build its work program for 2004 around these two topics but pursue a broader agenda consisting of four topics. Accordingly, it proposes to prepare 4 summary reports corresponding to the four topics. As has been already requested by the TWG, the Forum will submit two of them (Projects 2 & 4 below) to the APEC Process. As to the remaining other two (Projects 1 & 3 below), the Forum would be pleased to submit them as well to the FMM if so requested by the TWG. Of this two, Project 1, in particular, is proposed as a truly collaborative project between PECC and APEC, as explained below.

1) Strengthening the Domestic Financial Systems in the Emerging Economies: Assessment of Progress and Remaining Challenges

This topic is meant to correspond to the country case studies component of the APEC work program explained above, and specifically to complement the work of TWG on the subject matter.

It is proposed that the Forum will prepare and propose a framework in which to assess the vulnerabilities of the domestic financial systems to financial crises in a world of free and volatile capital flows. *The framework paper will be prepared and presented by a PECC expert for this purpose.*

It is further proposed that the members of the Forum would assess, using the framework thus developed, and reviewing the reforms and restructuring that have been undertaken since the latest crises, the progress made by APEC economies toward strengthening the domestic financial systems, and identify any further work to be done by governments. In order to organize such assessment, the Forum will see if TWG would be willing to allow the Forum members to access and examine a few as a sample, or all, of the country studies to be prepared by the officials for the TWG Meeting. The Forum will try to derive a generalized assessment of the progress toward financial reforms and restructuring in the emerging economies in the region on the basis of this examination.

A specific proposal is that *the Forum will examine about four case study reports (1~2 from Latin America, plus 2~3 from East Asia) in the form of discussions on them, consisting of presentations by APEC officials followed by discussants from PECC.* Alternatively, if officials would be reluctant to present their specific cases, TWG may be requested to make available as many case study reports as possible for generalized assessment by PECC experts without asking officials to

present them. Presentations would be made by PECC experts and participants will be invited from TWG to comment on those presentations.

Collaboration with TWG will be especially critical to the success of this project.

A separate *paper on corporate governance reform for banks*, addressing both the framework for assessment and the current state of the reform, will be prepared and presented by Dr. Jess Estanislao, President and CEO of the Institute of Corporate Directors, Philippines, on behalf of PECC.

For 2005 : The proposed project under the current heading will be considered later for possible extension into a comparative scorecard exercise on financial reforms, including those on corporate governance in banking, in the emerging markets in the next phase of the work of the Forum.

2) Reforming the International Financial Architecture : Progress to Date, Unsolved Problems, and Challenges to the APEC Economies

The PECC report on this topic will be presented to the TWG/FMM and establish the background against which the officials will discuss the specific ways of enhancing the efficacy of the international financial architecture in helping economies cope with financial instabilities. Three succinct survey papers will be presented and discussed at the Forum Conference.

- *The Post-Crisis Reform of the International Financial Architecture : Issues, Progresses, and Prospects;*

- *The Current International Financial Architecture from the East Asian Perspective : Problems, Options, and Challenges;*
- *The Current International Financial Architecture from the Latin American Perspective : Problems, Options, and Challenges*

For 2005 : The proposed project under the current heading will be considered later for extension into a larger project to be carried out in the next phase of the Forum's work on the vision of the international financial architecture for the APEC region, supplemented with detailed examination of prospects and the vision for regional financial architecture in East Asia and possibly in Latin America, too.

3) Managing International Reserves under Flexible/Managed Exchange Rates : Policy Issues and Challenges to the APEC Economies

A paper will be prepared and presented by a PECC expert *on* how the APEC economies are *holding and managing* their *international reserves*, the political economy of such behaviors, and the policy issues and challenges they may present from both the national and the international perspective. Findings from the discussion of this paper may be incorporated into the report on the international financial architecture.

4) Capacity-Building Measures for the Development of Domestic Bond and Regional Bond Markets in the APEC Region

PECC and ABAC will jointly hold a *Conference on Developing Bond Markets in APEC : Moving Forward through Public-Private Sector Partnership*, in Taipei on May 10-11, 2004, for the purpose of identifying the appropriate capacity-building measures for the promotion

of the domestic bond markets as well as regional bond markets in the APEC region. Specific capacity-building needs to be addressed include : expanding the institutional investor base, developing a strong regional credit-rating industry, promoting region-wide convergence toward international financial reporting standards, and promoting effective insolvency and creditor rights systems domestically and regionally.

This PECC/ABAC conference will be preceded by a meeting of the ABAC/PECC Advisory Group on APEC Financial System Capacity-Building to be held in Taipei on May 9.

A report on the findings from this conference as well as the pre-conference meeting of the Advisory Group will be prepared and presented to the Forum Conference. To establish the background to the discussion of this report, a paper on the importance of developing bond markets domestically and regionally will also be prepared and presented.

For 2005 : The proposed project will be expanded later into a project that will produce a comprehensive report on the financial-system capacity-building in 2005, complemented by an additional project on how to strengthen risk management in the non-bank financial sector.

This project will be undertaken under the joint coordinatorship of Messrs. Julius Caesar Parrenãs (Chinatrust Financial Holdings & the Taiwan Institute of Economic Research) and Dr. David Hong (TIER), both representing the PECC Finance Forum, and Mr. Ken Waller (Commonwealth Bank of Australia) who represents ABAC.

IV. Time Schedule

- The work program finalized and papers assigned by February 16.

- Discussants for the Forum Conference designated and the Conference program finalized by March 31.
- PECC convenes the Spring meeting of the Standing Committee in Beijing on April 17-18.
- The 2nd Meeting of the ABAC/PECC Advisory Group on APEC Financial System Capacity-Building held in Taipei on May 9.
- The PECC/ABAC Conference on Developing Bond Markets in APEC held in Taipei on May 10-11.
- All participants confirmed by May 14.
- Draft papers submitted on-line by May 31.
- Prepared comments/presentations by discussants submitted by June 11.
- The Finance Forum Conference held in Santiago, Chile, on June 21-22.
- The APEC Finance Ministers TWG Meeting held in Arica, Chile, on June 23-25.
- Reports to the APEC FMM submitted by July 12.
- The Work Program of the Finance Forum for 2005 launched by July 12.
- The APEC FMM held in Santiago on September 2-3.
- The ABAC/PECC Advisory Group meeting held in conjunction with the APEC Financiers' Group meeting to be held in Santiago at the time of FMM.
- PECC convenes the Fall meeting of the Standing Committee, by which time the proceedings of the Finance Forum Conference will be published.