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How Can Regional Institutions Support Reforms to Domestic Financial Systems

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Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

How Can Regional Institutions Support Reforms to Domestic Financial Systems

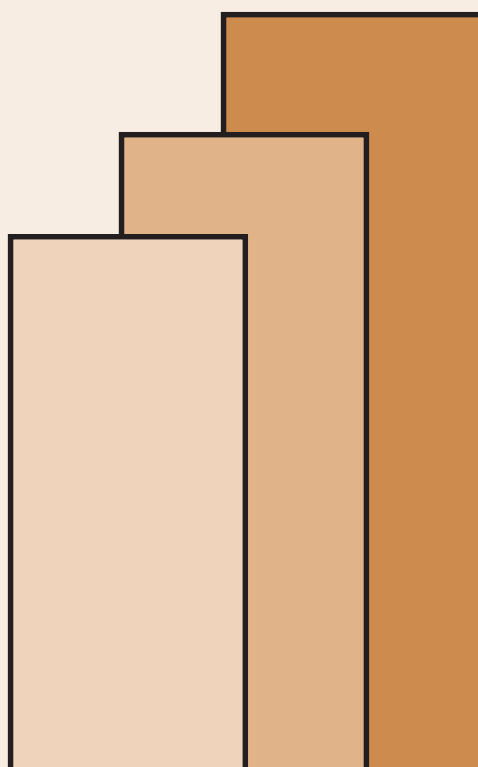
Mario B. Lamberte

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HOW CAN REGIONAL INSTITUTIONS SUPPORT REFORMS TO DOMESTIC FINANCIAL SYSTEMS¹

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Abstract

More recently, considerable attention has been given to financial regional integration and cooperation, which intensified in the wake of the East Asian financial crisis. Thus, a number of regional initiatives, such as development of regional bond market and credit rating agencies, among others, have been put forward to form part of the foundation of regional financial integration. New regional institutions have been created to support such initiatives. However, these efforts cannot and should not be taken as a substitute for measures needed to strengthen domestic financial systems. To begin with, domestic financial systems in many countries in the Asia-Pacific region have remained weak, and progress to reform them has been highly uneven. This paper attempts to offer some ideas about how regional institutions can support reforms to domestic financial systems.

Key words: regional financial integration, financial sector reforms, banking, insurance

I. Introduction

The last 15 years was particularly interesting to the world financial system. Many countries including transition economies have introduced major reforms to strengthen their domestic financial institutions and make them more competitive. GATS was ratified and accepted by members in January 1999. Along with these developments is the emergence of so-called “best practices” or “standards”, which initially were adopted by a small group of countries but were subsequently accepted by many countries.² This is in recognition of the fact that many financial transactions have become global in character as a consequence of financial sector liberalization undertaken by many countries. For example, a deposit can be transacted by a resident in her home-country or abroad. The same can be said of loans and securities transactions.

¹ A paper presented during the 4th APEC Future Economic Leaders Think Tank held in Sydney, Australia from 30 June to 2 July 2004. The author is grateful to Jose Maria B. Ruiz and Juanita Tolentino for research assistance.

² Developed countries do not have a monopoly on “best practices”. For example, “best practices” in microfinance originated from developing economies.

More recently, considerable attention has been given to financial regional integration and cooperation, which intensified in the wake of the East Asian financial crisis. Thus, a number of regional initiatives, such as development of regional bond market and credit rating agencies, among others, have been put forward to form part of the foundation of regional financial integration. New regional institutions have been created to support such initiatives. However, these efforts cannot and should not be taken as a substitute for measures needed to strengthen domestic financial systems. To begin with, domestic financial systems in many countries in the Asia-Pacific region have remained weak, and progress to reform them has been highly uneven.

This paper attempts to offer some ideas about how regional institutions can support reforms to domestic financial systems. In the next section, we discuss the reform measures undertaken by countries in the region to strengthen their financial systems. The third section examines ways by which regional institutions can contribute to reforms of domestic financial systems. The last section concludes.

II. Financial Sector Reforms in the Asia-Pacific Region

With the exception of more economically advanced economies in the APEC region, most countries in the region are heavily dependent on the banking system for financial intermediation (**Table 1**). Most equity markets are thin, accounting for less than 100 percent of GDP, while the bond markets are still at their nascent stage.

APEC-member countries have undertaken reforms in the last decade to improve domestic financial stability, strengthen supervision and regulation of financial institutions, enhance competition and widen the array of financial instruments. It is to be noted, however, that these reforms were undertaken mainly under the initiative of individual countries. Thus, the pace, approaches and depth of the reforms vary across countries in the region.

**Table 1. Financial Sector:
APEC and Some Non-APEC Member Countries**

Country	M2 / GDP (%)	Year	Market Capitalization / GDP (%)	Year
APEC Member Countries				
Australia	82.3	2003	101.5	2001
Brunei			- no available data -	
Canada	65.7	2002	100.9	2001
Chile	38.4	2003	85.4	2001
China	179.0	2002	45.2	2001
Hong Kong, China	259.1	2003	312.6	2001
Indonesia	54.9	2002	15.8	2001
Japan	133.5	2002	54.4	2001
Korea, Rep.	76.7	2003	55.0	2001
Malaysia	102.6	2003	135.1	2001
Mexico	29.1	2003	20.5	2001
New Zealand	40.1	2003	35.3	2001
Papua New Guinea	29.4	2002	-	
Peru	32.4	2002	18.1	2001
Philippines	40.0	2003	29.9	2001
Russia	29.8	2003	24.6	2001
Singapore	115.8	2002	137.0	2001
Chinese Taipei			- no available data -	
Thailand	97.7	2003	31.7	2001
USA	55.6	2003	137.2	2001
Vietnam	62.4	2003	-	
Non-APEC Member Countries				
Cambodia	18.4	2002	-	
Lao PDR	20.9	2003	-	
Myanmar	34.3	2001	-	

Sources: International Financial Statistics CD-ROM (May 2004); World Development Indicators 2003 CD-ROM.

A. Monetary and Supervisory Framework

Increased appreciation of the need for having independent central bank and supervisory and regulatory authorities had led countries to change their legal framework for these institutions. However, while there is convergence of policies in the region as far as making monetary and supervisory authorities independent is concerned, differences in monetary policy framework and financial supervision approach among APEC-member countries have remained (**Table 2**). Some countries in the region have switched to inflation targeting as their monetary policy framework, making monetary more transparent and central bank more accountable to the public. Indonesia, Korea, Philippines and Thailand switched to inflation targeting after the 1997-98 financial crisis.³

³ Some observers have even claimed that Japan's current monetary policy framework is now closer to inflation targeting. For example, see Ito and Mishkin (2004).

**Table 2. Monetary Policy Framework and Financial
Sector Supervisory and Regulatory Structure
As of June 2004**

Countries	Explicit Inflation Targeting	Unified Financial Supervision (partial & full)
<i>APEC Member Countries</i>		
Australia	X	X
Brunei		
Canada	X	X
Chile	X	X
China		X
Hong Kong, China		
Indonesia	X	
Japan		X
Korea, Rep.	X	X
Malaysia		X (partial)
Mexico	X	
New Zealand	X	
Papua New Guinea		
Peru	X	
Philippines	X	
Russia		
Singapore		X
Chinese Taipei		X
Thailand	X	
USA		
Vietnam		
<i>Non-APEC Member Countries</i>		
Cambodia		
La PDR		
Myanmar		

As regards financial sector supervision, most countries in the region have put emphasis on strengthening the capacity of supervisory and regulatory authorities. Because of blurring of distinction among financial institutions resulting from recent financial sector deregulation, some countries in the region have recently adopted a unified financial supervision approach by creating an independent supervisory authority to supervise and regulate all financial institutions, leaving the central bank to deal with monetary policy.⁴ China and Taiwan are the latest additions to the group of countries in the region that have adopted a unified supervisory and regulatory approach. Indonesia and Thailand are seriously considering of adopting the unified financial supervision approach, but they have yet to implement the enabling laws to materialize such plan.⁵ In the Philippines, this issue is still debated especially since it requires not only passing laws but also changes in Constitution. These differences in the monetary policy framework

⁴ The exception here is Singapore. The Monetary Authority of Singapore (MAS) supervises and regulates all financial institutions and at the same time conducts monetary policy. In the case of Malaysia, the Bank Negara Malaysia (BNM) took over the supervision of the insurance industry in 1988.

⁵ In Indonesia, the new Central Bank of 1999 for the unification of financial sector supervision under an independent Financial Services Supervisory Institution which was to be established before 31 December 2002. However, the proposed law creating such institution has not yet been passed.

and financial sector supervisory and regulatory structure in the region are likely to remain for quite some time.

B. Banking and Insurance

Although reforms to address structural weaknesses of the financial systems in the region were done as early as the 1980s, however, these were done in bits and pieces by most countries, and often in response to a domestic or regional crisis. One of the early reforms was to deregulate the financial system by easing entry of new domestic and foreign financial institutions to improve the efficiency of domestic intermediation. Most of the APEC member countries acceded to the GATS. The GATS negotiations in the financial services sector include two broad categories of services: insurance and insurance-related services and banking and other financial services. APEC member countries' level of commitments in GATS in financial services greatly varies, ranging from a low of 0.2 to a high of 0.8 for both banking and insurance services.⁶ However, due to unilateral liberalization efforts, most countries in the regions currently have a higher degree of liberalization than what is reflected in their commitments in GATS as a result of their.⁷ Thailand, for instance, raised foreign equity in existing financial institutions from 49 percent to 100 percent since November 1997, but for a limited period of 10 years after which foreign ownership restrictions would again be imposed. Indonesia eased maximum foreign ownership of domestic banks as early as 1988, and liberalized it further in 1999 by allowing foreign equity in domestic banks of up to 99 percent. In the Philippines, a law was passed in 1994 allowing foreign banks market access through three modes: establishment of a branch; establishment of a subsidiary (i.e., up to 60 percent control); and acquisition of an existing domestic bank (up to 60 percent control). The General Banking Act of 2000 has further liberalized this law by allowing foreign banks to have wholly-owned subsidiaries. Singapore embarked a 5-year program starting in May 1999 to liberalize the domestic banking sector. Vietnam introduced in 1997 the State Banking Law that provides a legal framework for allowing foreign banks to establish a branch and to enter into joint venture with domestic banks. Aside from relaxing bank entry, countries in the region have moved towards the adoption of risk-based capital adequacy standards and good corporate governance for banking institutions.

The insurance industry was also subjected to major reforms, beginning with the changes in the legal framework to strengthen supervision of the industry and, at the same time, liberalize entry of foreign investors.⁸ Indonesia has opened general insurance to foreign participation since 1988. In the Philippines, a law was passed in 1996 deleting the Negative "C" List from the Foreign Investment Act, which in effect has allowed up to

⁶ The liberalization index ranges from 0 to 1. See Appendix A for details.

⁷ An exception perhaps is Malaysia which has not issued any new commercial banking licenses since 1970s. However, foreign banking institutions are free to acquire stakes in the domestic banking institutions subject to the aggregate foreign shareholding limit of 30 percent within each banking institution.

⁸ Countries that recently changed or amended the legal framework for the insurance industry are: Indonesia (1992); Singapore (2000); Malaysia (1996); Thailand 1992; Vietnam (?); and China (2003).

100 percent foreign equity in insurance companies.⁹ Thailand undertook a phased liberalization of its insurance industry beginning in 1997: first stage – allowing 25 percent of foreign equity participation in domestic insurance companies; second stage – foreign equity participation to be raised to 49 percent; and third stage – allowing more than 49 percent of foreign equity participation. China recently revised its Insurance Law so that it could comply its commitment to the WTO to open further its insurance market to foreign investors. Singapore lifted in 2000 the 49 percent limit on foreign ownership of local insurers. The Monetary Authority of Singapore (MAS) opened up completely the direct life and general insurance market to competition 2 years ago. It is currently working with the industry to achieve international best practices and standards by 2005. It is moving towards risk-based capital framework and is about to formally introduce corporate governance framework for the insurance industry.

C. Securities Market

Recognizing the need for accelerating the development of the debt securities markets, the five Asian countries have attempted to address major impediments to such development.¹⁰

Benchmark securities are important in pricing instruments both at the primary and secondary markets. Since 1998, Singapore has been implementing several measures to improve the benchmark yield curve, such as increasing the issuance of SGS bonds, re-opening of existing ones and extending the SGS maturities to 10 years. Singapore has recently extended further the SGS maturities to 15 years. In 1997, the Malaysian government mandated Khazanah, a wholly-owned government corporation, to issue benchmark bonds on a regular basis, i.e., 4 issues a year at intervals of 3 months (Tan 2000). As of 1999, Khazanah bonds accounted for 10 percent of the total outstanding government bonds.

The Philippines first experimented with floating-rate notes to introduce the market to long-term government securities. Then, in the second half of the 1990s, it replaced the floating-rate notes with fixed-rate T-notes and bonds and gradually extended the maturities to 25 years. In 2000, fixed-rate T-notes and bonds comprised 43 percent of the total outstanding government securities compared to only 8 percent in 1995. In Thailand, the re-issuance of government bonds under the Bt. 500 billion program in late 1998 has paved the way for the development of a benchmark for pricing securities. Developed by the Thai Bond Dealing center, the yield curve currently spans over the range of 0 to 15 years. It is based on bidding yield of all government bonds quoted by 9 primary dealers. A set of government bonds with maturity close to 1, 2, 5, 7 and 10 years are also selected to represent as benchmark bonds. Indonesia issued government bonds for bank recapitalization, which can hardly be used as benchmark bonds.

⁹ Entry is allowed under any of the following modes: ownership of the voting stock of an existing insurance or reinsurance company or intermediary; investment in a new insurance or reinsurance company or intermediary incorporated in the Philippines; or establishment of a branch.

¹⁰ This part draws on Lamberte (2003).

At the initial stages of the development of the debt securities market, the government plays a key role as a reliable supplier of debt securities. In Singapore, MAS conducts auctions of 3-month T-bills weekly and issues the 1-year T-bills, 2-, 5- 7-, and 10-year bonds according to a pre-announced issuance of calendar. The issue size ranges from S\$2.4 to S\$3.6 billion. Not only did the government increase the issuance of SGS but it also exhorted statutory boards to raise funds from the bond market to increase the supply of high quality bonds in the market rather than to continue to depend on bank credit. This is a bold move on the part of the Singaporean government considering the fact that statutory boards have been able to access bank loans easily and at reasonable rates. Singapore has also liberalized the policy on the non-internationalization of the S\$ in the past 3 years.

In March 2000, the Malaysian government started to announce the securities auction calendar to inform the public that it will be issuing MGS on a regular basis. It has also enlarged the size of MGS and consolidated the existing MGS issues into fewer larger issues, with issue sizes ranging from RM3 billion to RM5 billion and maturities from 3 to 10 years. To increase the supply of private debt securities, the Securities Commission became the sole regulator of all fund raising activities – a move that will speed up and reduce the costs of issuance of securities. The Commission recently introduced measures to facilitate approval of private debt securities issues, such as waivers of minimum rating requirements, the mandatory underwriting requirements and the minimum shareholders' funds. The government has granted a waiver from stamp duty for all instruments relating to the issue and transfer of private debt securities, which issue has been approved by Bank Negara Malaysia or the Securities Commission.

In the Philippines, the Bureau of the Treasury (BTr) conducts auction of T-bills every week on a Monday. The auction for the 2-year bond is done once a month and for the 5-, 7- and 10-year bonds once every quarter. The issue size ranges from PhP1 billion to PhP3 billion. Most recently, the government issued a 10-year zero coupon bond and, in view of the positive reception of the market, it plans to issue it on a regular basis. The Philippines has so far not seriously addressed major impediments to the supply of private debt securities. For instance, the existing Corporation Code requires the approval of corporate commercial paper (CP) issues only by the issuer company's board of directors but requires two-thirds majority of stockholders for bond issues. All issuances of CPs need to be registered with the Securities and Exchange Commission. One of the requirements for issuing a short-term CP is that the issuer should secure a credit line from commercial banks equivalent to at least 20 percent of its aggregate commercial paper outstanding at any time. This definitely raises the cost of issuing CPs. In the case of long-term CPs, which are considered by the market as the *de facto* bonds, issuers are not required to obtain a credit line from banks, but they must satisfy certain stringent requirements imposed by the SEC.

In Thailand, the government has recently re-started issuing T-bills partly to create a short-term benchmark for bond market and rationalized the auction of government securities by coming up with auction schedules. Thus, T-bills and government bonds are auctioned every Monday and Wednesday, respectively, and State enterprise bonds, every

other Tuesday. The law that prohibits the government from issuing bonds unless it runs into a deficit will be a major constraint on the part of the government to deepen and broaden the market for government securities. Indonesia has yet to formulate a program for developing the government debt securities beyond what it is doing now to recapitalize ailing banks.

Reforms were also introduced to stimulate demand for debt securities. Singapore does not impose a capital gains tax on SGS. The series of tax reforms introduced in 1998 and 1999 have been designed to give concessionary tax rates to investors of debt securities. For instance, interest income earned by financial institutions and corporations in Singapore from eligible debt securities is taxed at a concessionary rate of 10 percent. Non-residents holding SGS issued between 28 February 1998 and 27 February 2003 are exempt from withholding tax. As part of its effort to broaden the investor base of Singapore's debt securities market, the government has allowed starting in December 2000 non-residents to borrow S\$ freely to invest in S\$ financial assets including SGS, and Singapore Dollar bonds. In Korea, the government has promoted the participation of retail investors.

Malaysia has also provided tax incentives to encourage investors to invest in debt securities. More specifically, it provides tax exemption on interest earned by individuals investing in bonds issued by public companies listed in the KL Stock Exchange, on interest earned by individuals investing in bonds issued by a company rated by Rating Agency Malaysia Berhad or Malaysian Rating Corporation Berhad, and on interest income received by unit trusts and listed closed-end funds from corporate bonds. Withholding tax for foreign investors on interest earned has been reduced from 20 percent to 15 percent since October 1994. More recently, the government grants a waiver from stamp duty for all instruments relating to the issue and transfer of private debt securities, which issue has been approved by Bank Negara Malaysia or the Securities Commission.

In contrast, Thailand and the Philippines retain a complicated tax system that tends to reduce the returns on investing in debt securities. In Thailand, for instance, individual investors are subject to a 15 percent withholding tax on interest income and on capital gains. In the Philippines, there is a 0.15 percent documentary stamp tax on issuance/acquisition of securities and a 20 percent withholding tax on interest income on bond investments.

The market infrastructure for developing the debt securities market is pretty well in place in Singapore. Primary dealers in the SGS market provide liquidity to the SGS market by quoting two-way prices under all market conditions and underwrite issuance of SGS auctions. There are dealers representing various financial institutions and banks that maintain book-entry SGS accounts with MAS for their own trading. To support the market-making activities of primary dealers, the government has recently established a repo facility for primary dealers. Since 1998, profits generated by primary dealers from trading in SGS are exempted from tax. An efficient clearing and settlement system supports the SGS market. The MAS maintains a register of all SGS and transactions are

cleared T+1 on a DvP basis over the MAS electronic payment system and MAS' SGS Book-entry clearing system. Same day settlement can be made if transactions are entered before 3:30 PM. To provide the market with up-to-date information about the debt securities market and enhance transparency of the market, MAS posts daily the SGS closing and high-low prices on its website.

Malaysia introduced much earlier a Principal Dealer System in which market makers were appointed for certain types of debt securities. The principal dealers are to provide reasonable continuous 2-way price quotations for these papers to individuals, institutional clients and Bank Negara Malaysia (BNM). However, principal dealers are reluctant to make markets because of the high cost of holding and the lack of papers. Also, there is an existing regulation against short-selling and there is no infrastructure for bond lending. In short, principal dealers not prepared to make two-way quotes unless they are willing to take additional risks. Malaysia has put in place other infrastructure for both the primary and secondary market for government securities. In particular, it automated its primary auction process for government securities in 1996. This is supported by a real time gross settlement (RTGS) system called RENTAS, which replaced in 1999 an earlier netting system for settlement of trades in securities. The government set up a Bond and Information and Dissemination System (BIDS) in 1997 to promote awareness of the bond market and enhance the transparency of the OTC market. An important measure made by BNM for the primary corporate bond market was the mandatory rating for all issuances of domestic debt securities. Malaysia has currently two credit rating agencies. To improve the efficiency of secondary trading of PDS, BNM has required that all unlisted PDS be issued scripless, with clearing and settlement executed electronically via the RENTAS.

Like Malaysia, the Philippine government through the Bureau of the Treasury (BTr) conducts auctions of Treasury bills and bonds using an electronic system, supported by a book-entry registry system. However, settlement is not on a DvP system but on a same day netting system. It has more than 40 accredited government securities dealers, who are not required to make two-way quotes. There currently exist two credit rating agencies in the Philippines, but the government does not mandate issuers to have their issues rated. Most recently, the SEC has granted a privately owned fixed income securities exchange a license to operate.

In Thailand, T-bills, BoT and FIDF bonds are issued scripless form and transferred by book entries, all handled by the Bank of Thailand. Similarly, corporate bonds are issued in scripless form and transferred by book entry, but cleared and settled at Thailand Securities Depository Co. The creation of the Thai Bond Dealing Centre (TBDC) is an important step towards developing the secondary market for bonds. Dealers are required to report to TBDC all traded transactions to provide the market with information on prices. A similar effort was made in Indonesia with the creation of the Over-the-Counter Fixed Income Service (OTC-FIS) located in the Surabaya Stock Exchange. The difference though is that traders are not required to report their trading transactions to the OTC-FIS. Scripless trading of securities has been available in

Indonesia since 1998. Rating of commercial paper and bond issues is mandatory in Indonesia. Rating is performed by two credit rating agencies in Indonesia.

Korea, which has a relatively developed bond market, has introduced reforms that included improvement in the bond-issuing procedure, introduction of new debt products and reorganization of the secondary bond market (ESCAP-ADB 2002).

Despite these reforms, the quality of the financial infrastructure for the bond market for most countries in the region is still far from those that have fairly well developed bond markets (**Table 3**).

The equity markets in most East Asian countries are still underdeveloped. However, their growth in the last 15 years has been more rapid compared to their debt securities market. Reforms ranging from strengthening the capacity of supervisory and regulatory authorities, enhancing protection of minority shareholders, shifting from “merit-based system” to “full disclosure approach”, to addressing insider abuse of listed corporations have been introduced to enhance public confidence in the equity markets in the regions. In the Philippines, a new securities regulation was passed in 2000 to strengthen the independence of the SEC and give it greater flexibility to oversee the debt and equity markets. China introduced its new securities law in 1998. In Singapore, the Securities and Futures Act was passed in 2001 that sets out the regulatory framework for the capital markets in a single piece of legislation.

Governance of the stock exchanges has been strengthened. Most stock exchanges in the region are either in the process or have completed the transition from a mutual society to company and listing their shares. Singapore established in December 1999 the Singapore Exchange, which is the first demutualized, integrated securities and derivatives exchange in the Asia-Pacific region. Most of the equity markets in the APEC region had opened trading for participation by foreign investors in the 1990s.

**Table 3. Indicators of Quality of the Financial Infrastructure
(0 to 10 scale, higher is better)**

	Delivery and Settlement	Benchmark Yield Curve	Public Issuance Modality	Private Issuance Modality	Average Score	Ranking of East Asian Countries
Hong Kong, China	8	8	8	8	8.0	1
Singapore	8	8	8	8	8.0	1
Taipei, China	8	4	8	8	7.0	2
Korea, Rep. of	6	6	8	6	6.5	3
Malaysia	6	4	6	6	5.5	4
Thailand	4	4	4	4	4.0	5
PRC	2	0	2	0	2.0	6
Philippines	2	0	4	0	1.5	7
Indonesia	2	0	2	0	1.0	8
US	10	10	10	10	10.0	

Notes on Ranking Criteria:

Delivery and Settlement: Speed and reliability are the qualities that are most desired here. The existence of a tested electronic, scriptless book entry system leading to real time gross settlement and the widespread use of the same defines the first best. In comparison, physical delivery and settlement are subject to delays, disruption, and loss in transit. Hong Kong, China; Singapore, and Taipei, China have the most sophisticated system even for cross-border connections. In Indonesia and the Philippines, scriptless book entry is only being planned. Some kind of central depository and settlement exists in the PRC and Thailand.

Benchmark Yield Curve: A yield curve must not only cover all maturities but must be market-driven enough for price marking. A deep and liquid government bond market covering all maturities is a crucial prerequisite for this. PRC, Indonesia, and Philippines do not yet have a reliable yield curve across maturities. Thailand has a yield curve but it is still in a somewhat nascent stage. Korea and Malaysia's yield curves are based on government securities that carry some implicit subsidy.

Public Issuance Modality: The premium here is on market orientation and, thus, proper pricing of indebtedness. Auction is the most desirable form followed by underwriting and, finally, tap. Auction can be electronic and remote or physical and open cry. Many countries may employ all three depending on the circumstances. Hong Kong, China; Korea; Singapore; and Taipei, China are leaders in these categories. Malaysia has some dependence on pension and other institutions under mandatory requirement. PRC, Philippines, Thailand already have electronic/remote auctions and primary dealer system but still leave room for improvement.

Private Issuance Modality: Again, market orientation is the key segment here. Auction of private issuance is still uncommon; underwriting or private placement is the preferred route. PRC, Indonesia, and Philippines do not have infrastructure (the PRC has legal impediments to private issuance; the Philippines has stiff shareholder approval for the same; while in Indonesia, SOEs perform the issuing). Thailand has a rudimentary market for private corporates. Korea and Malaysia exhibit some dynamism but again implicit subsidies exist. Hong Kong, China; Singapore; and Taipei, China are the leaders.

Source: *Fabella and Madhur (2003)*.

D. Financial Infrastructure

The quality of the overall financial infrastructure in APEC-member economies greatly varies. The indicators of the quality of financial infrastructure shown in **Table 4** clearly suggest that emerging economies in the region need to put more attention to this area to catch up with other countries. There have been efforts in this regard, such as adoption of internationally accepted accounting standards strengthening institutions to eradicate corruption (e.g., simplifying tax procedures and automation, creating special commercial courts).

Table 4. Indicators of Quality of Financial Infrastructure
0 to 10 scale, higher is better

	Total Score	Contract realisation	Lack of corruption	Rule of law	Bureaucratic quality	Accounting standards	Press freedom
Developed East Asian markets	8.27	9.02	8.45	8.94	8.81	7.60	6.80
Australia	9.06	8.71	8.52	10.00	10.00	8.00	9.12
Hong Kong	7.75	8.82	8.52	8.22	6.90	7.30	6.72
Japan	8.67	9.69	8.52	8.98	9.82	7.10	7.92
Singapore	7.58	8.86	8.22	8.57	8.52	7.90	3.44
Emerging East Asian markets	5.84	7.27	4.96	5.60	5.02	6.70	5.47
Indonesia	3.52	6.09	2.15	3.98	2.50	n/a	2.86
Korea	6.73	8.59	5.30	5.35	6.97	6.80	7.36
Malaysia	6.55	7.43	7.38	6.78	5.90	7.90	3.90
Philippines	4.14	4.80	2.92	2.73	2.43	6.40	5.54
Taiwan	7.50	9.16	6.85	8.52	n/a	5.80	7.16
Thailand	6.50	7.57	5.18	6.25	7.32	6.60	6.02
Reference markets	8.96	9.32	8.87	9.29	10.00	8.10	8.25
United Kingdom	8.93	9.63	9.10	8.57	10.00	8.50	7.78
United States	9.00	9.00	8.63	10.00	10.00	7.60	8.72

Source: de Brouwer and Corbett (2002).

Insolvency laws have attracted considerable attention in recent years due to the collapse of many large and medium-sized corporations in the wake the East Asian financial crisis. These laws are antiquated and/or were hardly used at all in the past.¹¹ Thus, recently substantial reforms have been made to improve the effectiveness of these laws either through amendment, as in the case of Thailand, or issuing new implementing rules and regulations, as in the case of the Philippines and Indonesia. Both Korea and the Philippines are in the process of amending their respective insolvency laws.

E. Reform Plans¹²

APEC-member countries are continuing their reform efforts to strengthen their financial systems. Some are approaching the reforms in a more systematic manner. For instance, Bank Negara Malaysia launched in March 2001 a Financial Sector Masterplan (FSMP), which is a ten-year road map for the country's banking and insurance sectors. The FSMP includes specific recommendations that are to be implemented in phases over the next 8 to 10 years. Thailand is doing the same. In 2002, the Bank of Thailand set up a committee tasked to draw up a vision and framework for the development of the country's financial sector. Bank Indonesia unveiled in early 2004 the Indonesian Banking Architecture (IBA), which serves as a basic framework for the development of the Indonesian banking system over the next 5 to 10 years. Other countries in the region do not have master plans but have several proposed reform measures, such as restructuring the supervisory structure, reforming financial intermediation taxes, etc., that are being considered by their legislative bodies.

¹¹ Indonesia (1905); Philippines (1909, 1981); Thailand (1940); Hong Kong (1984); Malaysia (1965); Japan (1922); Taipei, China (1935); Korea (1962);

¹² This draws on Milo (2004).

III. Regional Institutions and Reforms of Domestic Financial Systems

The institutionalization of interactions between sovereign states has become more prominent in the 20th century, thus the rapid growth of international institutions. Scholars have been busy trying to explain why states turn to international institutions and what influence they have on patterns of state behavior. However, the last 20 years saw a much rapid growth in regional institutions. The contagious effect of a crisis on a particular region, dissatisfaction with the use of “one-size-fits-all” standards or approaches, and failure of international institutions like WTO to reach agreements have led to the formation of new regional institutions (e.g., Chiang Mai initiative, bilateral FTAs, etc.). All this seems to suggest that there are instances in which regional institutions can do a better job than international institutions in attaining the same objectives. We will return to this issue later.

The concept of international institution has been defined in various ways by scholars. This paper, however, subscribes to Mersheimer’s definition of international institutions, which has been endorsed by Simmons and Martin (2002). That is, “international institution is a set of rules that stipulate the ways in which states should cooperate and compete with one another.” A closely related concept of international institution is international organization which has a formal structure that “embodies and sustains one or more institutions.” Not all international institutions have a formal structure. An example often cited is the GATT. In the East Asian region, ASEAN+3 can be cited as an example.¹³

We define regional institution in the same way international institution is defined above, except that its operation or coverage is limited to states within a geographic location (e.g., Southeast Asia, Asia-Pacific, etc.). In the analysis that follows, the paper will confine itself only to regional institutions that can support reforms to domestic financial systems.

Table 5 provides a list of major regional institutions and the corresponding participating economies. Aside from those shown in the list are nongovernmental regional institutions that provide inputs to the reforms of domestic financial systems in the region.¹⁴ The various regional institutions and arrangements have overlapping membership with core members including most, if not all, of the ASEAN member countries. It is to be noted that most of these regional institutions are not governed by treaties and the degree of their formality varies in the sense that some are being supported by a secretariat with specific organizational structure while others are not.

¹³ Duffield (2002) has suggested a method of classifying international institutions based on ontological (i.e., intersubjective norms, coincident norms and rules, and formal rules) and functional (i.e., constitutive, regulative and procedural) distinctions.

¹⁴ See Appendix B for a more detailed description of these governmental and nongovernmental regional institutions.

Table 5. Regional Institutions

	Financial Ministries and/or Central Banks							Central Banks			Multilateral
	ASEAN (10)	ASEAN+3 (13)	MFG ^a (14)	APEC (21)	ACD (22)	ASEM ^b (25)	APG (26)	SEANZA (20)	SEACEN (11)	EMEAP (11)	ADB (63)
Year Established	1967	1999	1997	1994	2002	1997		1956	1966	1991	1966
Japan		*	*	*	*	*	*	*		*	*
China		*	*	*	*	*	*	*		*	*
Korea		*	*	*	*	*	*	*	*	*	*
Hong Kong			*	*			*	*		*	*
Chinese Taipei				*			*		*		
Singapore	*	*	*	*	*	*	*	*	*	*	*
Brunei	*	*	*	*	*	*	*		*		*
Cambodia	*	*			*						*
Indonesia	*	*	*	*	*	*	*	*	*	*	*
Laos	*	*			*						*
Malaysia	*	*	*	*	*	*	*	*	*	*	*
Myanmar	*	*			*						*
Philippines	*	*	*	*	*	*	*	*	*	*	*
Thailand	*	*	*	*	*	*	*	*	*	*	*
Vietnam	*	*		*		*					*
Mongolia								*	*		*
Macao								*			
Papua New Guinea				*				*			*
Australia, New Zealand			*	*			*	*		*	*
Nepal, Sri Lanka					*			*	*		*
Bang., India, Iran, Pak.					*		*	*			except Iran
USA, Canada			*	*			*				*
Chile, Mexico, Peru				*							
Bahrain, Kuwait, Oman, Kazakhstan					*						Kazakhstan
Qatar					*						
Russia				*		*					
EU-15						*					

Note: (a) MFG includes the IMF, World Bank, ADB and BIS.

(b) ASEM includes European Commission.

Sources: Kuroda and Kawai (2003) and Asian Development Bank website, www.adb.org. This was updated to include new information.

As discussed in the previous section, each country in the region had introduced reform measures to strengthen their domestic financial systems. Although the ultimate objectives of the reforms are basically the same, the strategy, which consists of the scope, approach, and pace, of the reforms have varied. The role of regional institutions is not to modify each country's objectives of the reform but rather to alter the environment and constraints so that countries change their strategies or pattern of behavior in a way that can help them attain the same objectives more efficiently and effectively. Only in this way that regional institutions can have meaningful and significant contributions to the reforms of domestic financial institutions. This brings us to three key questions:

1. How can regional institutions make a difference to reforms of domestic financial institutions?
2. Under what conditions can they make such contributions?
3. What regional institution can best deliver such contributions?

To answer the first two questions, we borrow Martin's (1997) classifications of possible effects of regional institutions on the domestic economy, namely: substitutes and complements. Understanding these effects can provide clues as to how regional institutions can provide support to domestic financial systems.

Regional institutions might serve as substitutes for domestic mechanisms and institutions. The conditions under which such effect occurs are well-known in the literature and in fact have already been alluded to by Girardin (forthcoming) and Eichengreen (2002), namely: market failure; weak domestic institutions; and time-inconsistent preferences or self-control problem. Let's discuss each of these conditions by citing some examples.

Market failure occurs when individually rational behavior leads to outcomes that leave everybody worse off. For example, it is good for a country to attract capital regardless of the shade of the capital. However, some money flows are laundered money, which if sizeable and volatile can lead to financial instability. A coordinated action is therefore needed to address this problem and avoid a free-rider problem. Mechanisms of regional institutions such as peer review can be used to strengthen coordination. Another example is cross-border insolvency problem. In an increasingly integrated financial market, creditors and debtors may not necessarily live in the same jurisdictions. Without adequate legal protection to both, cross-border investments may not occur; or it may occur but at a less optimal level than if such problem does not arise. If the region is the reference point for cross-border investments, collective action, such as reforming the insolvency law or passing a law supporting mutual recognition of insolvency laws, is required to address this problem.

Regional institutions can also substitute for weak domestic institution. Decision-makers within a country may not be monolithic, not to mention the fact that vested interests exist to block domestic reforms. A case in point is capital adequacy. Banking regulators may want to adopt “best practices” or “standards” in measuring bank capital but they could not do so for lack of political support. Regional institutions can substitute for that weakness by setting the standards that work for every jurisdiction in the region and act as counterweight to domestic vested interests opposing the reform.

The problem of time-inconsistency has been discussed well by Girardin (forthcoming). Right after the East Asian financial crisis, most countries had thought of introducing wide-ranging reforms to strengthen domestic financial institutions and diversify financial instruments. However, their resolve to complete the reforms has waned over time, and many of these proposals have not been pursued intensively by proponents. Through the peer review mechanism, regional institutions can lessen the time-inconsistency problem facing each member country.

Regional institutions can complement the effects of domestic reform efforts. The existence of economies of scale and scope can lead to a condition under which countries find regional institutions as complements. Countries in the region could be facing similar sources of weaknesses in their financial institutions and are individually implementing reforms to address such weakness. There could be some scope for reducing the cost of the domestic reform through, for example, regional information sharing, research and capacity building.

Some examples could be cited here. In the wake of the regional financial crisis, crisis-affected countries had set up asset management companies (AMCs) to serve as a vehicle for cleaning up NPLs of banks. However, AMCs vary significantly in their design and performance, and trigger moral hazard-inspired bank lending (Terada-Hagiwara and Pasadilla 2004). Exchange of information at an earlier stage among crisis-affected countries regarding the design of their AMCs could have helped crisis-affected countries develop more effective AMCs. Such exchange of information could be facilitated by a regional institution. The experience of several countries in the region

with respect to having a unified approach to supervision of financial institutions could be shared among themselves especially those countries that are in the process of adopting such approach.

Some reforms needed for domestic financial system would require capacity-building on the part of supervisory and regulatory agencies. For example, the skills needed to perform risk-based approach to supervision of domestic financial institutions are substantially different from the traditional approaches. Such enormous requirement could weaken the resolve of regulatory authorities to undertake the needed reform. Of course, such skills could be developed through training programs designed and implemented individually by the supervisory agencies. However, economies of scale and scope could be exploited by conducting such training in a regional training institution.

Countries may be hesitant to undertake reforms if they have incomplete information especially about the conditions that could lead to the intended results. Collaborative regional research effort could provide more satisfactory answers at lesser cost than research individually done by each country.

It does appear at first blush that the contributions of regional institutions to reforms of domestic financial system can be made by international institutions; hence, there is no need for regional institutions. This is not an entirely correct assessment of the possible contributions of regional institutions vis-à-vis international institutions. First, countries around the world are not homogeneous in many respects, and therefore “one-size-fits all” approaches or standards will not be appropriate and therefore cannot work effectively. Therefore, such approaches need to be adapted to regional conditions. Take for example the so-called “international standards”. Given the highly concentrated, family owned businesses proliferating in the Asian region and the prevalence of self-dealing or related party transactions, good corporate standards applicable in Western countries would not work well in the Asian region. Eicheengreen (2002) also suggested to develop a regional regulatory standard for financial institutions considering the fact that conditions in the region are different from those of other regions. Second, ownership of the reform agenda and processes is important in effectively implementing the reforms. Regionally developed standards that satisfy the intentions of international standards can be readily accepted by countries in the region.

The last question we tackle is what regional institution to be used to influence or facilitate the reforms of domestic financial systems in the region. Eicheengreen (2002) proposed to create an Asian Financial Institute (AFI) on the platform of ASEAN+3. We shared the comments of many critics of this proposal such as too costly and abrupt. Instead, we recommend to make use of existing regional institutions. **Table 6** provides a summary of the areas of interest of existing major regional institutions. Note, however, that for many of these regional institutions the areas of interest are changing and evolving through time in response to the needs of members. There is considerable overlap of areas of interest among regional institutions that is also reflected in the programs they implement. Therefore, a mechanism for better coordination among the various regional

institutions needs to be developed to eliminate serious overlapping areas of interest and programs.

IV. Concluding Remarks

In the past decade, reforms of the domestic financial systems have been undertaken by individual APEC-member economies without much coordination. These reforms were accelerated right after the East Asian financial crisis. However, the reform process slowed and proponents' interest in such reforms seem to have waned. Recently, On the other hand, there seems to be more attention given recently to financial regional integration and cooperation. Thus, a number of regional initiatives, such as development of regional bond market and credit rating agencies, among others, have been put forward to form part of the foundation of regional financial integration. However, these efforts cannot substitute for measures needed to strengthen domestic financial systems.

This paper has offered some ideas as to how regional institutions can support reforms to domestic financial systems. More specifically, they can serve as substitutes for domestic mechanisms and institutions and can complement the effects of domestic reform initiatives. The paper recommends to make use of existing regional institutions. However, because existing regional institutions have currently overlapping areas of interest and programs, the paper further recommends to develop mechanisms for closer coordination among these regional institutions to reduce such overlap.

Table 6. Interactions among Institutions and Arrangements in East Asia

Areas of Interest	ASEAN	ASEAN+3	MF	APE	ASE	AC	SEANZ	SEACE	EMEA	PEC	ARC	AP	ACRA	AD	BI
1. Strengthen domestic institutions and markets				x					x		x	x			
2. Develop regional arrangements and markets															
2.1. <i>Policy dialogue and surveillance</i>	x	x	x		x			x							
2.2. <i>Regional financial and capital markets</i>		x		x		x			x				x		
2.3. <i>Regional financial arrangements</i>	x	x													
2.4. <i>Monetary policy and exchange rate systems</i>															
3. Capacity building	x			x	x		x	x						x	x
4. Research	x	x		x	x			x	x	x				x	

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Appendix A.1

Banking (Acceptance of Deposits and Lending) 1997

Selected APEC Member Countries	Cross Border Supply			Consumption Abroad			Commercial Presence					
	Deposits	Lending	Index	Deposits	Lending	Index	Legal Form	# of Sup	Equity	# of Oper	# of Trans.	Index
ASIA & PACIFIC												
Hong Kong, China	U	U	0.000	N	N	0.000	LT	DL		LN	LV	0.600
Indonesia	N	N	0.050	N	N	0.013	LL	U	LO1	LN		0.800
Korea, Rep.	U	U	0.075	U	U	0.040		DL	LO1		LV	0.200
Malaysia	U	LC	0.000	N		0.000		U	LO1	U		0.400
Philippines	U	U	0.160	N	N	0.040	DL	DL	LO2	LN	LV	0.600
Singapore	U	U	0.160	N	N	0.040		U	LO1	LN	DL	0.800
Thailand	U	U	0.000	U	U	0.000	LL	DL	LO1	LN		0.200
Vietnam												
Brunei												
China												
Chinese Taipei												
NON-APEC MEMBER COUNTRIES												
Cambodia												
Laos												
Myanmar												
LATIN AMERICA												
Chile	U	U	0.000	U	U	0.000	LL	DL	DL			0.200
Mexico	U	U	0.000	U	U	0.000			LO1			0.400
Peru	U	U	0.000	U	U	0.000	LL	DL			LV	0.200
HIGH-MID INCOME												
Australia	LC	LC	0.080	N	N	0.040	LL	N	N	LN		0.600
Canada	N	N	0.160	N	N	0.040	LL	N	LT	N		0.600
Japan	LC	LC	0.080	N	N	0.040	LC	N	N	N	N	0.400
New Zealand	U	U	0.000	N	N	0.040	N	N	N	N	N	0.800
United States	LC	LC	0.080	N	LC	0.028	LL	N	N	N	N	0.600

Note:

Code	Type of Commitment	Index Value
U	"Unbound" against relevant mode	0.00
DL	Discretionary Licensing or Economic Needs Tests	0.25
LC	Limited commitments	0.50
LO1	Limits on ownership less than 50% (minority)	0.50
G	Grandfathering Provisions	0.75
LL	Limits on Legal Form	0.75
LN	Limits on number of operations (branches)	0.75
LO2	Limits on ownership more than 50% (minority)	0.75
LT	Limits on types of operations (branches vs. subsidiaries)	0.75
LV	Limits on value of transactions or Assets	0.75
RE	Reciprocity condition or MFN exemption	0.75
N	Full Bindings or "None" Limitations against relevant mode	1.00

Source: Quian (2003).

Appendix A.2

Insurance (Life and Non-Life) 1997

Selected APEC Member Countries	Cross Border Supply			Consumption Abroad			Commercial Presence				
	Life	Non-life	Index	Life	Non-life	Index	Legal Form	# of Sup	Equity	Other	Index
ASIA & PACIFIC											
Brunei	U	U	0.000	N	N	0.040	LL	U	U		0.600
Hong Kong, China	U	U	0.000	N	N	0.040	LL				0.600
Indonesia	U	U	0.000	DL	DL	0.010			LO2		0.600
Korea, Rep.	U	U	0.000	U	U	0.000	LL		LO2		0.400
Malaysia	U	DL	0.025	U	DL	0.006	LL	U	LO2		0.600
Philippines	U	U	0.000	U	U	0.000		DL	LO2		0.200
Singapore	U	U	0.000	N	N	0.040		U	LO1		0.400
Thailand	U	U	0.000	N	N	0.040		DL	LO1		0.200
Vietnam											
China											
Chinese Taipei											
NON-APEC MEMBER COUNTRIES											
Cambodia											
Laos											
Myanmar											
LATIN AMERICA											
Chile	U	U	0.000	U	U	0.000	LL	DL			0.200
Mexico	U	U	0.000	U	U	0.000			LO1		0.400
Peru	U	U	0.000	U	U	0.000	LL	DL		LV	0.200
HIGH-MID INCOME											
Australia	U	U	0.000	N	N	0.040	LL	N	LT	LT	0.600
Canada	LC	LC	0.080	LC	LC	0.020	LL	N	N	RE	0.600
Japan	U	LC	0.050	U	LC	0.013	N	N	N	N	0.800
New Zealand	U	U	0.000	U	U	0.000	N	N	N	N	0.800
United States	LC	LC	0.080	N	N	0.040	LL	N	LT	LN	0.600

Note:

Code	Type of Commitment	Index Value
U	"Unbound" against relevant mode	0.00
DL	Discretionary Licensing or Economic Needs Tests	0.25
LC	Limited commitments	0.50
LO1	Limits on ownership less than 50% (minority)	0.50
G	Grandfathering Provisions	0.75
LL	Limits on Legal Form	0.75
LN	Limits on number of operations (branches)	0.75
LO2	Limits on ownership more than 50% (minority)	0.75
LT	Limits on types of operations (branches vs. subsidiaries)	0.75
LV	Limits on value of transactions or Assets	0.75
RE	Reciprocity condition or MFN exemption	0.75
N	Full Bindings or "None" Limitations against relevant mode	1.00

Source: Quian (2003).

REGIONAL INSTITUTIONS

The Association of Southeast Asian Nations (ASEAN) was established in 1967. From 5 original member countries, it has since grown to 10 member countries. It is committed to promoting closer regional economic integration. In its Framework of Agreements on Enhancing ASEAN Economic Cooperation issued in 1992, ASEAN member countries agreed, among others, to: (1) strengthen and develop further ASEAN economic cooperation in the field of capital markets, as well as find new measures to increase cooperation in this area; (2) and encourage and facilitate free movement of capital and other financial resources, including further liberalization of the use of ASEAN currencies in trade and investments, taking into account their respective national laws, monetary controls and development objectives. The ASEAN Vision 2020, which was drafted and approved in the midst of the 1997 East Asian financial crisis, includes an agreement to maintain regional macroeconomic and financial stability by promoting closer consultations in macroeconomic and financial policies. This agreement was further fleshed out in the Hanoi Plan of Action, which includes, among others, the strengthening of the ASEAN Surveillance process, development of the ASEAN bond markets, and studying the feasibility of establishing an ASEAN currency and exchange rate system.

The **Asia-Pacific Economic Cooperation (APEC)** was established in 1989 to further enhance economic growth and prosperity for the region and to strengthen the Asia-Pacific community. It consists of 21 member economies situated in Asia and the Pacific. It is considered unique in that it represents the only intergovernmental grouping in the world committed to reducing trade barriers and increasing investments without requiring its members to enter into legally binding obligations. The “Bogor Goals” of free and open trade and investment in the region by 2010 for industrialized economies and 2020 for developing economies were adopted by APEC Leaders in 1994. APEC focuses on 3 areas: trade and investment liberalization; business facilitation; and economic and technical cooperation. In the area of financial cooperation, the APEC Finance Ministers agreed during its 4th meeting held in 1997 to adopt voluntary principles to achieve the following core conditions: (i) a sound macroeconomic environment; (ii) stable and transparent legal and regulatory systems; (iii) well-developed market infrastructure; (iv) efficient financial and capital markets institutions; and (v) an array of available financial instruments to meet the region's diverse financing and investment needs. The APEC Economic Leaders created the APEC Advisory Council (ABAC) to provide a business perspective on specific areas of cooperation. ABAC comprises of up to three members of the private sector from each country.

Japan's idea of creating an Asian Monetary Fund in the wake of the East Asian financial crisis did not take off the ground due to strong objections from the US and IMF and lack of support from China, the largest economy in the region. In November 1997, the deputy finance ministers and central bank governors from 14 countries in East Asia and the Pacific met in Manila, and at the conclusion of said meeting issued “A New

Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability”. This framework includes 4 initiatives: (1) a mechanism for regional surveillance to complement global surveillance by the IMF; (2) enhanced economic and technical cooperation particularly in strengthening domestic financial systems and regulatory capacities; (3) measures to enhance the IMF’s capacity to respond to financial crises; and (4) a financial cooperative arrangement that would supplement IMF resources. The members of this group, which later became known as the **Manila Framework Group (MFG)**, and high level representatives from the IMF, World Bank, ADB, and recently BIS meet twice a year to discuss financial developments in the region as well as in each member-country and review implementation of its initiatives. It does not have a permanent secretariat but for the moment the IMF’s Regional Office for Asia and the Pacific acts as the secretariat.

The **Asia-Europe Meeting (ASEM)** was organized in 1997 to serve as a mechanism for strengthening the linkage between Asia and Europe. This forum consists of 25 member countries from both East Asia and Europe and the President of the European Commission. Summit-level meetings are supposed to be held every second year, Ministerial-level meetings in the intervening years and several meetings and activities at the working level. The meetings of Finance Ministers give opportunities for exchanging views on macroeconomic outlook and development in the financial sector and for exploring means of cooperation in several areas of common interest to both East Asia and Europe. During its first meeting held in Bangkok in 1997, the Finance Ministers agreed on a set of initiatives, which include, among others, the following: ASEM discussion on the Euro and its implications on global and Asian financial markets; strengthening cooperation in financial supervision and regulation; and enhancing macroeconomic policy consultation. A major initiative of the ASEM process is the Kobe Research project which aims to collect useful information on the experiences and lessons learned in regional cooperation in Asia and Europe.

The **ASEAN+3** group, which consists of the 10 ASEAN member countries, China, Japan and Korea, was formally organized in 1999. In the area of monetary and financial cooperation, the ASEAN+3 members incorporated in their “Joint Statement of East Asia Cooperation” an agreement to strengthen policy dialogue, coordination and collaboration on the financial, monetary and fiscal issues of common interest, focusing initially on issues related to macroeconomic risk management, enhancing corporate governance, monitoring regional capital flows, strengthening banking and financial systems, reforming the international financial architecture, and enhancing self-help and support mechanism in East Asia through the ASEAN+3 Framework, including the ongoing dialogue and cooperation mechanism of the ASEAN+3 finance and central bank leaders and officials. The ASEAN+3 has 3 major initiatives to foster closer financial cooperation in the region, namely: information exchange and surveillance; regional financial arrangement under the Chiang Mai Initiative (CMI); and the Asian Bond Market Initiative (ABMI).

The **Asia Cooperation Dialogue (ACD)** is the latest addition to existing institutions that provides a venue where Asian countries can freely discuss issues of

common interests and put forward measures to enhance mutual cooperation in all areas. During the first Ministerial Meeting held in Thailand in June 2002, the participants agreed to pursue several objectives under this forum, one which is to expand the trade and financial market within Asia and increase bargaining power of Asian countries in lieu of competition, and in turn enhance Asia's economic competitiveness in the global market. It consists of 22 countries, mainly from Asia and a few from the Middle East. During the second meeting in Thailand in June 2003, the participants agreed to exert efforts to develop a strong and resilient financial system in order to prevent future economic and financial crises and to take concerted steps needed to reduce the region's vulnerability to fluctuations in international movements.

The **Asia/Pacific Group (APG)** on money laundering was established in February 1997. Its purpose is to facilitate the adoption, implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism and to ensure that regional and jurisdictional factors are taken into account in the implementation of international anti-money laundering and anti-terrorist measures. It is a voluntary and cooperative group. It is an autonomous group whose existence is not derived from an international treaty. It has currently 26 member jurisdictions and 13 observer jurisdictions. It has two instruments. One is the self-assessment exercises, in which every member provides information on the status of its implementation of the Financial Action Task Force's Forty Recommendations. The other is mutual evaluation, in which each member is being evaluated by its peers on the basis of detailed questionnaire and a subsequent on-site visit conducted by a team of at least three selected experts from legal, financial and law enforcement fields of other APG members. The APG meets twice a year. A Secretariat located in Sydney, Australia provides administrative support to the APG.

The **South East Asia, New Zealand and Australia (SEANZA)** is the oldest organization, which originally was formed outside of East Asia¹⁵ and later on included most of the East Asian countries. It has currently 20 member economies. Central bank governors who represent their respective countries meet annually. It promotes cooperation among central banks in the region by conducting intensive, biennial central bank training courses (Fraser 1995). Its specific objectives are: to assist in the development and training of senior officers for higher central banking executive positions; to build up knowledge of central banking, with particular reference to conditions the in SEANZA countries; to promote understanding of developing countries; and to foster friendly relations and technical cooperation among central banks in the SEANZA region. The hosting of training courses is rotated among member countries.

The **South East Asian Central Banks (SEACEN)** was organized in 1966 to provide a forum for SEACEN central bank governors for exchanging information and ideas to enable the governors to be familiar with each other and to gain deeper understanding of the economic conditions of the individual SEACEN countries. It is currently composed of 12 countries in Asia. In 1972, it set up a training and research centre located in Kuala Lumpur. The SEACEN Centre became a separate legal entity in

¹⁵ The original members are Australia, India, New Zealand, Pakistan and Sri Lanka).

1982. The Centre's objectives are: to promote a better understanding of the financial, monetary, banking and economic development matters which are of interest to the central banks and monetary authorities of the countries in South East Asia or of interest to the region as a whole; and to stimulate and facilitate cooperation among central banks and monetary authorities in the area of research and training. These objectives are carried out through its research and training activities as well as through its advisory and technical services.

The **Executive Meeting of East Asia and Pacific Central Banks (EMEAP)** group was formed in 1991 with the initiative of Japan to strengthen cooperation among its members. Like SEANZA and SEACEN, its members consist of central banks and monetary authorities in the East Asia and Pacific region. EMEAP's activities are conducted at three levels. Starting in 1996, the governors meetings have been held to exchange ideas and information regarding recent economic and financial conditions in the region. Since 1992, the deputies' meetings have been held twice a year also to discuss recent changes in economic and financial conditions in the region and to follow up activities conducted by working groups. Currently, EMEAP has 3 working groups, namely: working group on payment and settlement system; working group on financial markets; and working group on banking supervision.

Aside from intergovernment arrangements discussed above, there are at least five non-governmental regional fora that have or can play a major role in promoting closer financial cooperation in the region. One is the **Pacific Economic Cooperation Council (PECC)**, which was organized in 1980 as a tripartite partnership of senior and individuals from business and industry, government and academic and other intellectual circles. Its main objective is to serve as a regional forum for cooperation and policy coordination to promote economic development in the Asia-Pacific region. It is the only non-governmental official observer of APEC. Because of its independence and status as a non-government entity, PECC is able to provide a forum for discussing regional cooperation without being constrained by governmental policies or views. It has organized the PECC Finance Forum to assess the international environment for financial stability and development in the region, to assess progress in the promotion of financial reforms, integration and cooperation in the region, and to develop the desired vision of regional financial and monetary cooperation.

The second non-governmental arrangement is the **Asian Bankers Association (ABA)**, which was organized in October 1981 to provide a forum for advancing the cause of banking and finance industry and promoting economic cooperation in the Asia-Pacific region. It has been submitting position papers to APEC Economic Leaders through the APEC Business Advisory Council on matters related to the strengthening of domestic financial institutions and development of Asia's local currency bond markets and credit rating agencies. It currently has 120 member-banks from some 25 countries in the Asia-Pacific region.

The third non-governmental arrangement is the **OECD-Asian Roundtable on Corporate Governance (OECD-ARCG)**, which serves as a regional forum for

structured policy dialogue on corporate governance. The forum is an informal arrangement which is participated in by Asian policy makers, regulators, business leaders and regional and international experts. Roundtable meetings were held from 1999 to 2003 to discuss ways of improving corporate governance in non-OECD member countries of the Asian region taking into account particular features of the Asian corporate landscape.

The fourth is the **Association of Credit Rating Agencies in Asia (ACRAA)**, which was established in September with the assistance of the ADB. This group consists of 15 credit rating agencies in Asia.

The fifth is the **Network of Asia Pacific Institutes (NAPII)**, which primarily consists of those institutions which in their countries are by and large responsible for insurance education. It has currently 12 member insurance institutes from 12 countries 11 countries in the region. The UN is represented in this network. Among its objectives is to assist in and facilitate the development of regional insurance projects, in particular, those projects, which by nature, would not be desirable or feasible to be implemented by national participants but should involve foreign participants in the ASEAN and Asia-Pacific region or elsewhere.

Multilateral agencies also support regional efforts aimed at developing closer financial cooperation. ADB provides support to regional policy dialogues through its regular reports, such as its quarterly Asia Economic Monitor and semestral Vulnerability Assessment Report, special studies and technical assistance. The BIS also started to make its presence felt in the region by establishing a Representative Office for Asia and the Pacific in 1998. It seeks to contribute to the work of the central banking groupings in the region through partnerships and participation in seminars (McCauley 2003).