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The Integration of Capital Markets in the Asian Region: Some Practical Steps Forward

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Abstract

This paper looks at practical measures to advance economic and financial integration in the Asian region. A common theme in literature on this topic is that, to provide greater diversity and stability in saving and investment opportunities for those in the region, it is necessary to boost cross-border activity within Asia and beyond and to improve the efficiency and stability of national financial systems. Three steps to achieve this are outlined: creating a regional platform for financial transactions; adopting common international standards and mutual recognition in finance and business activity; and removing the impediments to cross-border finance. The paper recognises that this is a difficult task as the Asian region faces serious constraints in opening financial systems: lack of political will; lack of private-sector interest because of weaknesses in governance; and the sheer complexity of the task, compounded by a lack of capacity in the private and official sectors. It is argued that faced with these constraints, the best way to make progress is to make better use of the region's various policy forums and for governments in the region to more actively engage with the private sector and global institutions.

THE INTEGRATION OF CAPITAL MARKETS IN THE ASIAN REGION: SOME PRACTICAL STEPS FORWARD

Gordon de Brouwer and Lorraine Allan•

There has been a major shift within Asia in the past decade to strengthen national economic and financial systems and markets, and to form cooperative arrangements with the intention of strengthening the region's financial stability and economic growth.

The motivation for this is varied. It is partly a reaction to the economic and social havoc of the financial crises of 1997 and 1998. It is partly to ensure that financial markets and systems can meet the increasingly complex needs of Asian households and firms as their cross-border trade, investment and people movement increases, both in the region and beyond. It is partly to digest the increasing importance of China and India in the Asian and global economies and to facilitate necessary market and policy adjustment and reform in those two countries, the Asian region generally, and the rest of the world. And it is partly a recognition that while Asia may be a leader in world trade with growing influence on the global economic cycle, it is not so in the world of international finance, notwithstanding the region's large foreign exchange reserves. There is a growing sense that the region needs to develop much further in the domain of finance.

In thinking about the way forward for capital and financial integration in the region, it is necessary to have a purpose or endpoint in mind. In short: what is the aim of financial development and integration in Asia? This really is a complex issue, especially in the real-world political economy of international economic engagement and relations. For the purposes of this paper, we simplify the story by saying that the aim of financial development, integration and openness in Asia is to support economic and social development and stability in the region. It is a basic insight of economics that well-functioning national financial systems, markets and institutions support the consumption, saving, and investment choices of households, firms and governments, which form a substantial part of economic wellbeing. To do this as well as it can, domestic finance generally needs to be open to the world in all of its domains: active in international markets; engaged with international intermediaries; and based on the best of international standards and practices.

If the aim of financial development is to improve economic wellbeing, the imperative of financial development in Asia is surely now great. If saving in Asia becomes safer because intermediation is more effective and secure and portfolios are more diverse and balanced, the need for precautionary saving would be less. Saving rates in the region should fall and private demand should rise. And if a wider, more accessible and cheaper range of funding mechanisms becomes available, investment rates in the region should increase. The great ongoing economic consequence of the financial crises of 1997 and 1998 has been the substantial weakening of investment rates in the crisis-affected economies, in some cases by up to 10 per cent of GDP; investment in non-China East Asia might have been too low in most of the past decade.

The possibility of more efficient and lower saving and higher consumption and investment could have two important implications. First, the region itself would be on a better footing to achieve more balanced growth – balanced in the sense, first, that it would be based more on domestic demand and less on external demand than before and, second, that investment would be putting in

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place production possibilities for the future that currently are not there. Second, the world would be on a better footing because the reduction in saving and increase in investment in Asia would reduce the region's current account surpluses, and help resolve current global imbalances, which is widely regarded as one of the key medium-term risks to global stability.

This paper looks at what can be done in a practical way to advance economic and financial integration in the Asian region. There are now many papers on this topic.[1] The key insight from this literature is that, to provide greater diversity and stability in saving and investment opportunities for those in the region, it is necessary to boost cross-border activity within the Asian region and beyond and to improve the efficiency and stability of national financial systems. We outline three steps to achieve this: creating a regional platform for financial transactions; adopting common international standards and mutual recognition in finance and business activity; and removing legal, informal or behind-the-border impediments in cross-border finance.[2] But this is not easy. The Asian region faces serious constraints in opening financial systems: lack of political will; lack of private-sector interest because of weaknesses in governance; and the sheer complexity of the task compounded by a lack of capacity in both the private and the official sector. We argue that the best way to make progress in the face of these constraints is to make better use of the region's various policy forums, including APEC, and for governments in the region to more actively engage with the private sector and global institutions.

Steps forward in developing and integrating financial systems in the Asian region

There are three steps that can be taken at this stage to advance cross-border activity in the Asian region.

The first step is creating the transactions platform for cross-border financial trade. As Yam (2005: 5) states, this requires establishing the 'linkages between jurisdictions across the whole spectrum of financial infrastructure – the trading, payment, clearing, settlement and custodian systems for money and for financial instruments.' Given the importance of trade to the region, the expansion of intra-regional trade, and the growth in money, debt and equity markets in the region, it is likely that there is an underlying real demand for such transactions platforms. In its recent report on bond market settlement, the ADB (2005) recommends establishing transparency in pricing and market infrastructure, compliance with international standards, regional cooperation, and further study on how to reduce risks to facilitate cross-border investment.

The second step to enable cross-border trade is agreeing to common standards and principles for financial activity. These standards and principles cover the licensing, regulation and supervision of financial firms, corporate and financial governance and reporting standards and requirements, and the regulation of market transactions. This also includes mutual recognition of regulated financial entities and listing and reporting requirements between jurisdictions, in order to allow financial firms to operate across national borders easily. And it requires an assessment of how taxation affects capital flows in the region.

There is general and strong agreement that harmonisation of standards and principles should be global wherever possible.[3] Yam (2005: 6) refers to this as the 'adoption of minimum acceptable

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[1] For a recent well-argued example, see Yam (2005) and Kato (2005). See also de Brouwer and Corbett (2003) and de Brouwer (2005) for assessments of the current state of, and prospects for, financial and monetary integration in East Asia.

[2] See Fukasaku et al (2005)

[3] See de Brouwer (1999).

international standards' and he explicitly emphasises the word "international", arguing that there 'should not be a different set of regional standards, although there may need to be some flexibility to address specific regional issues.'

The third step in advancing cross-border trade in finance is to remove legal or informal restrictions on cross-border trade in financial assets and liabilities. Restrictions exist in a number of ways. They are most obvious in terms of formal restrictions on the capital account which limit cross-border investment and activity.

This is not to advocate full liberalisation of the capital account in emerging market or transition economies. There is broad consensus on the need to match international financial openness to the financial depth, stability and development needs of the particular economy. But it is to recognise that, as Yam (2005: 7-8) notes, 'greater capital mobility is the necessary condition for financial integration across jurisdictions … [and] … would result in more efficient allocation of resources.' And it should also recognise that legal restrictions often overstate the effective restrictions on cross-border financial activity, especially when trade, foreign direct investment and people movement are extensive (as is the case with much of Asia) and countries share common land borders. In this case, formalising what is occurring anyway can provide more certainty to rights and obligations, reduce business and financial risks, and improve economic and financial depth and stability.

Restrictions also exist in the differential treatment of foreign and domestic financial entities, limiting entry by foreign intermediaries into domestic financial markets. Restricting entry limits competition in the domestic market. It constrains efficiency. It retards innovation and reform. And it is not an effective safeguard against domestic financial instability, which is the claim often made in defence of differential treatment (see Yam 2005: 6). If the quality of governance, oversight and rule of law is weak, then differential treatment can be a device for corruption and the expropriation of private and public funds.[4]

The key areas of differential treatment cover the gamut of financial services – banking, insurance, and funds management. And they cover the range of financial institutions – banks and other deposit taking institutions, insurance companies, and private collective investment vehicles such as pension funds, mutual funds, and hedge funds. The argument here is not that these markets and entities should be unregulated. Experience dictates that (market-conforming) regulation and supervision are essential. Rather, it is that regulation and practices should in general not seek to treat domestic and foreign financial intermediaries differently.

Put together, these three steps – creating a regional platform for financial transactions, harmonising standards and practices in the region, and easing capital controls and differential treatment of foreign financial institutions – can seem rather daunting. But they can occur, of course, over time and progressively, especially the latter two.

Constraints in financial development and integration in the Asian region

Achieving integration is not easy. There are three constraints that are most apparent.

The first constraint is that action on these issues requires political willingness to engage on the substance of the issues, to act to reform and internationalise domestic systems, and to cooperate with other governments and institutions in the region and beyond. The politics of financial integration in the Asian region is complicated. On the one hand, there is fear of losing market share

[4] Cheung, Rau and Stouraitis (2003) provide a detailed analysis of how weak governance can lead to expropriation in the Hong Kong stock market.

and status to others, concern about foreign domination (not just by the United States and Europe but competitors in the region), scepticism about the benefits of financial openness, and a visceral fear of crisis (Yam 2005). On the other hand, there is a growing political momentum in Asia to deepen regional cooperation, in response to the experience of the financial crisis, the increasing economic integration of the region, and a desire to embed sound and consistent market-based systems and practices in key emerging and transitional economies in the region, especially China. The combination of these factors implies that progress in integration can ebb and flow – it is likely to be discontinuous, subject to jumps forwards and backwards, and not always be smooth.

The second constraint is the willingness of the private sector to enter Asian financial markets and institutions.[5] Individuals and business want some certainty that their investments – be it a purchase of stocks or bonds or running a local branch or institution – are not subject to unnecessary risk. Given the commercial opportunities inherent in the ongoing development of Asian economies, the engagement of the private sector in Asian finance ultimately depends on the strength of domestic governance – an environment of recognised and enforceable property rights, the fair and effective rule of law, and a lack of corruption.[6]

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[5] See ADB (2005) Roundtable Meeting of Institutional Investors.

[6] See OECD (2005) and Kato (2005) for more detailed arguments and exposition.

Table 1: Corporate Codes in the Asian Region

Economy	Date of main code	Example 1: independent director required	Example 2: audit commitment required
China	2002	Yes	Yes
Hong Kong SAR	1993/2004	Yes	Yes
India	1999	Yes	Yes
Indonesia	2001	Yes	Yes
Japan	2004	Optional	Optional
Korea	1999/2003	Yes	Yes (large firms)
Malaysia	2001	Yes	Yes
Philippines	2002	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002	IPOs only	Encouraged
Thailand	1999	Yes	Yes

Source: Allen (2005).
Note: shading indicates that requirement existed in January 1997 before the financial crisis.

It appears that governance is generally improving in the Asian region but still has some way to go. As an example, consider the recent assessment of corporate governance in Asia by the Asian Corporate Governance Association (ACGA) shown in Table 1 (Allen 2005). The striking feature of Table 1 is how few economies in Asia had corporate codes before the financial crisis started in 1997.

Allen (2005) reports that there has been improvement and convergence in codes of corporate governance (meant to embody best practice), stock exchange listing rules, securities laws, company law and director duties, accounting laws and standards, and rules or codes for fund managers, analysts and intermediaries in the Asian region. These changes have been driven by market changes (especially from the United States and United Kingdom, which, because of recent corporate collapses, have undergone substantial internal review of governance) and the acceptance of principles and standards set by international bodies (like by the IAIS, IASB, IFA, OECD and IOSCO)[7] – this is an indication of the importance of international experience and standards.

But the ACGA also argues that improvement and convergence to global standards is relatively superficial and could benefit from better enforcement and implementation, closer engagement between regulators and market participants, clear regulatory and market incentives for better

[7] IAIS – International Association of Insurance Supervisors; IASB – International Accounting Standards Board; IFA – International Federation of Accountants; IOSCO – International Organisation of Securities Commissions; OECD – Organisations for Economic Cooperation and Development

practice, and action against insider trading and market manipulation (including by financial institutions) (Allen 2005).

The view that there has been some improvement since the crisis in governance in general in the Asian region is supported by other indicators. Table 2, for example, provides Transparency International's measure of the private sector's perception of corruption over the past decade. It indicates mixed and modest improvement in most economies in the Asian region, although there is clearly a long way to go in most economies to reach the level of Singapore (see also Kato 2005).

The third constraint is the sheer enormity of the task that faces the region and the limited capacity it has to achieve it. The size of what is yet to be done in Asia is apparent in two respects. One is the obvious economic and institutional diversity of the Asian region itself, ranging from developed industrialised economies like Japan, Singapore, Australia, Hong Kong SAR and New Zealand, to low-income economies like Cambodia, Laos and Myanmar, with the full range in between.

The other is the range of – and interconnectedness between – the reform, market infrastructure, and institutional development that is needed in Asia. Growing and integrating financial systems does not just involve getting regulatory and market systems right for financial activities like banking, insurance, and funds management, and for institutions which are privately or publicly owned.[8] It also entails understanding the effect that an action in one domain of the financial system has on other aspects – the way the development of bond or equity markets or the regulatory process for firms to cease trading, for example, can affect the banking system. And, to work well, it means getting governance, corporate insolvency regimes, legal systems and the associated 'soft' market infrastructure in place and operating effectively.

[8] Consider the sale of investment products in Hong Kong SAR, for example. A fund manager wishing to issue a guaranteed fund is regulated by the Securities and Futures Commission and must go through an extensive process of registration. An investment bank selling a structured note, however, is regulated by the Hong Kong Monetary Authority and faces an easier more informal approval process. Yet both the fund manager and investment bank are selling similar products to the same kind of client.

Table 2: Transparency International's Measure of Business Perceptions of Corruption in the Asian Region

Economy	1995	2000	2005
Australia	8.8	8.3	8.6
China	2.2	3.1	3.2
Hong Kong SAR	7.1	7.7	8.3
India	2.8	2.8	2.8
Indonesia	1.9	1.7	2.2
Japan	6.7	6.4	7.3
Korea	4.3	4.0	5.0
Malaysia	5.3	4.8	5.1
Philippines	2.8	2.8	2.5
Singapore	9.2	9.1	9.4
Taiwan	5.1	5.5	5.9
Thailand	n/a	2.5	2.6

Source: Transparency International website, accessed 21 October 2005.
Notes: higher number indicates less corruption; n/a indicates not available.

This means that reform needs to be consistent across the various branches of the financial sector and commercial sector in general. Holistic rather than piecemeal reform is preferable. There is a temptation to adopt changes to regulatory standards on a consecutive basis – for example, banks might be done first and insurance at some later date. But as the IMF notes,[9] financial legislation is often drafted on an institutional basis alone, and gaps or inconsistencies may emerge, particularly where the regulation of the financial sector is shared among several agencies.

There are now well-developed global principles and standards to guide countries towards best practice. Appendix A provides a summary. These principles and standards are meant to assist emerging market and transition economies in the development of their domestic markets and institutions. But there are a lot of these codes and they are often complicated in terms of how they are related to other parts of the policy and market systems. And they are complicated in terms of the understanding and skills they require in business and in government if they are to be implemented properly. There is a risk that global standards are beyond the current absorptive capacity of some countries.[10] For some of the less developed economies of the region, the financial needs of households and business are relatively basic. If so, global standards need to be prioritised by countries and their implementation planned and staggered over time, with capacity progressively

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9 IMF, *Financial Sector Regulation: Issues and Gaps*, prepared by Staff of the Monetary and Financial Systems Department, 4 August 2004

10 Walter (2002) argues that implementation failure may be such that it impedes development and growth.

and tactically built up in both the private sector and government to be able to implement and enforce them.

Standards and principles for regulation are constantly evolving to take account of changing circumstances, new practices and new technologies. It is not possible for most, or perhaps even all, countries to take on board new standards and principles as they are announced. There has to be first a foundation in both government and the market to support the changes, and then policy processes put into play within each country to determine how and when the change should be made. Individual characteristics within each country would be expected to have an effect in determining the rate of adoption of changes.

In introducing changes to a regulatory regime it is necessary to look at both sides of the regulation — the supervisory or regulatory body and the entities being regulated. For the supervisor there is the issue of determining how new standards will be applied, maybe involving consultation with the regulated entities, disseminating this information to the regulated entities, and training staff to implement new supervisory requirements. For the entities being regulated there is the need to understand what the change means, how they will be implemented and in some cases, changes in data and reporting requirements, with accompanying systems changes and associated costs. Also, there will need to be training of staff in the new requirements. This takes time and effort to be done properly.

The Asian region in general faces a lack of skills in accounting, finance and administration. China provides the most striking example because it is such a big country. China is currently estimated to have 60,000 qualified accountants, but there is a need for more than 350,000.[11] And China's insurance industry is reported to face a shortage of experienced underwriters and qualified actuaries.[12] Other countries also face shortages of skilled staff. A lack of skills can slow the pace of reform and can make implementation of new regulatory policies difficult.

To summarise, the Asian region needs further financial development and openness but the way ahead is not easy. Constraints on further financial development exist in terms of: political decision to open up the region's financial systems; business and government action to improve the 'soft infrastructure' that markets require to function well – things like effective governance, defined and enforceable property rights, and an absence of corruption; and, finally, in dealing with the sheer complexity and interrelatedness of the legal frameworks, standards and practices that decision makers need to reduce unnecessary risk.

Dealing with the constraints

Our view is that these constraints need not impede further financial development and integration in the Asian region. There are two ways to address the constraints that limit financial development and integration in the Asian region.

The first is for the region to pragmatically, strategically and fully use its array of institutions, forums and mechanisms to advance development and integration. The Asian region now has six processes in which to engage on economic and financial issues. These include: the Four Markets meeting (FMM); ASEAN; ASEAN and China, Japan and Korea (ASEAN+3); EMEAP central banks; East Asia Summit (EAS), bringing ASEAN+3 and Australia, India and New Zealand together; and APEC, both the Finance Ministers' process and various other relevant committees

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11 Fry, E, C*hina Syndrome*, CFO, 1 August 2005

12 Standard & Poor's, *Asia-Pacific Insurance Outlook 2005 – 2006*

like the Economics Committee.[13] Four of these processes are well developed (FMM, ASEAN, EMEAP and APEC), one is steadily developing (ASEAN+3 Finance Ministers process), and one is just starting (EAS). These processes are supported by a range of national and international institutions – national finance ministries/Treasuries and central banks, as well as the Asian Development Bank, World Bank, International Monetary Fund, Bank for International Settlements, and secretariats of ASEAN and APEC.

Ultimately, it is up to each county to implement a sustainable regime that will support its economic and social development and stability. But each of the processes listed above has something to offer financial development and integration in the Asian region.

- The Four Markets Meeting provides an opportunity for senior finance ministry and central bank officials from Australia, Japan, Hong Kong SAR and Singapore to talk about regulatory and financial issues of concern to them. The meetings are informal, substantive and frank.

- ASEAN and ASEAN+3 have shown their value in helping develop cohesion, consensus and political support and action in financial reform. Both processes culminate in a meeting of Finance Ministers, which gives them influence and political direction. ASEAN+3, for example, has proven successful in forming a regional mechanism for helping prevent financial crises – the network of bilateral swaps of foreign exchange reserves known as the Chiang Mai Initiative. The +3 countries are particularly important here because they have such large reserves of foreign exchange. ASEAN+3 has also provided a mechanism for greater discussion of economic and financial market issues in the region (that is, surveillance), and facilitated regular contact between the China, Japan and Korea on issues of international finance. ASEAN+3 has also worked extensively on the development of a regional bond market, specifically on working out ways to strengthen and expand domestic currency bond markets in emerging economies of the region. This is something to which Japan, with its experience in bond issues, brings insight (see Kuroda 2005).

- EMEAP is a central bank forum that provides effective, substantive and informal exchange between key central banks in the region. Its working groups – on payment and settlement systems, financial markets (especially foreign exchange, bond and money markets), and banks and other financial institutions – are highly regarded (Yam 2005). EMEAP has also made a substantial contribution to developing national bond markets in the region through its Asian Bond Fund programs, especially the second of these which actually pools national currency bonds of some developing EMEAP economies in a bundle for investors.[14] The EMEAP group is also useful to the region because it includes two economies with the most developed, sound and market-based financial and regulatory systems in the region, Hong Kong SAR and Australia.

- The East Asian Summit will meet at leaders' level in December 2005. By bringing ASEAN+3 and Australia, India and New Zealand together at the political level, it has the

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13 The Four Markets meeting includes Australia, Hong Kong China, Japan and Singapore. Member countries of ASEAN are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. Member countries of ASEAN+3 are the 10 ASEAN countries plus China, Japan and Korea. The EAS includes ASEAN+3 as well as Australia, India and New Zealand. EMEAP includes Australia, China, Hong Kong China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. Member economies of APEC are Australia, Brunei Darussalam, Canada, Chile, People's Republic of China, Hong Kong China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Chinese Taipei, Thailand, United States and Vietnam..

14 See Ma and Remolana (2005) for a detailed exposition.

potential to provide direction and leadership to economic and financial integration in the Asian region.

- APEC is a well-established forum for economic cooperation between economies of the Western Pacific and the Americas. The economic dimensions of APEC are very broad, including the forum's traditional focus on trade and investment, structural and reform issues in sub-forums like the economics committee, and financial systems, macroeconomic policy, and economic sustainability discussed in the Finance Ministers' process. There is a policy analysis and discussion focus in APEC, as well as a focus on practical targeted capacity building and strengthening. This latter aspect is worth emphasising. APEC can be a useful forum for capacity building and technical assistance because it includes a strong mix of developed and emerging market/transition economies with broad experience of markets and regulation. In this respect, APEC's diversity is in fact one of its key strengths. It is also the only regional forum that Asia has to engage with the United States, including at leaders' level.

Each of these forums has a role to play and the region's focus now should be on getting the most out of each forum that is possible. The region's forums are complementary to each other, even if there is some overlap in responsibilities and membership. While we always need to be mindful that these forums use public funds, we should also recognise that some overlap can be helpful in getting people used to and comfortable with a new idea, building consensus, and creating capacity in both government and the private sector. For example, as China, Vietnam and other countries adopt market-based economic systems, the region's various forums can play a particularly important role in helping bed down effective and well-functioning market systems in those countries, especially where the forum includes a number of developed market economies.

The layer of forums in the Asian region provides an opportunity to habituate decision makers in government and business to discussion and communication about domestic economic and financial issues with others, both in the Asian region and beyond. ASEAN+3, for example, has enabled more discussion during a period of economic transformation in Asia between the ASEAN countries and the +3 and between the +3 themselves. And APEC can facilitate discussion between the key powers of the Asia Pacific region, China, Japan and the United States, as well as bring the economic concerns of the region's smaller economies to the attention of the bigger ones.

Regional forums provide a device for the various international development and monetary institutions to bring their insights and knowledge in a targeted manner to the region. The region's forums, for example, can also be used strategically to unbundle the complexities of global standards and rules and prioritise action for the wide range of economies in the region. The APEC process can be particularly useful for this purpose, as shown by the range of policy and capacity building initiatives now running in the Finance Ministers' process (see Appendix B).

The second way to progress financial development and integration in the Asian region is openness, outreach and engagement. Finance is at its heart a global process, even if it can be nudged along at the regional level. Secure national systems and institutions founded in the global process provide the real gains for stable and strong saving, investment and economic growth.

To secure the gains of integration, governments in the region need to engage closely with the private sector – since private decision and action forms the basis of the market. There may also be market processes which will themselves make it easier for the region to overcome the constraints that hold back financial development and integration. Easier access to domestic markets by institutional investors, like mutual and pension funds or investment banks, for example, may provide greater market pressure for effective governance within firms and by government and help implement that governance (ACGA 2005). It is noteworthy, as shown in Table 3, that private funds management is not well developed across the Asian region, as shown by the scale of mutual funds in Asia. Greater engagement with the private sector too should enable governments to keep up faster with the changes that are always occurring in global markets. Globalisation is itself a changing feast (Knight 2005), and engagement with global markets ensures that the region is part of this ongoing change.

Table 3: Net Assets (US$ billion) and Number of Mutual Funds in the Asian Region

Economy	1998	2001	2004
Australia	$295 (n/a)	$334 (n/a)	$635 (n/a)
Hong Kong SAR	$98 (712)	$170 (952)	$343 (1,013)
India	$8.7 (97)	$15.3 (297)	$32.8 (394)
Japan	$376 (4,534)	$343 (2,867)	$399 (2,552)
Korea	$165 (13,442)	$119 (7,117)	$177 (6,636)
New Zealand	$7.3 (63)	$6.6 (588)	$11.2 (553)
Philippines	$0.1 (15)	$0.2 (20)	$1.0 (24)
Taiwan	$20.3 (174)	$49.7 (426)	$77.3 (445)
Reference Items			
United States	$5,525 (7,314)	$6,975 (8,305)	$8,107 (8,044)
World	$9,594 (50,266)	$11,654 (52,849)	$16,152 (55,528)

Source: Investment Company Institute (2005).
Notes: figure in parentheses is the number of mutual funds; Philippines' numbers for 1998 are 1999 date; n/a indicates not available.

Regional economies also need to participate fully in the international financial institutions (IFIs) of which they are shareholders. Full participation in these institutions will encourage them to be even more responsive to the needs and aspirations of the region. The IFIs also have a range of instruments that the region can use to help advance adoption of international standards. The World Bank and the IMF, for example, run a program of a joint Report on Standards and Codes (ROSC) which covers the twelve key standards outlined by the FSF. A ROSC is designed not just to assess existing national standards against international benchmarks but are also meant to assist countries in developing and implementing a country action plan for improving their institutional framework. To date, relatively few countries in the region have made use of the ROSC process. Similarly, the IMF and World Bank carry out Financial Sector Assessment Programs (FSAPs) but, to date, only eight countries in the Asian region have taken advantage of the opportunity to benchmark their financial systems against world best practice. These countries are India, Korea, New Zealand, the Philippines, Sri Lanka, Singapore, Bangladesh and Japan (Kato 2005); Australia is currently undergoing an FSAP.

Final Comment

The endgame of economic and financial cooperation in Asia is unclear. It is possible that the region will create some form of an economic community, although this is not a necessary outcome to the cooperation that is now in play. But, regardless of the endpoint, the interests of the region are served by having strong and effective governance and well-functioning financial systems, markets and institutions in place. In a world of substantial and increasing cross-border trade, investment and people movement, it is hard to restrict the movement of money and capital and undesirable to constrain financial development. And if the region does seek to implement monetary cooperation at some stage in the future, a sound and open financial system will be necessary to achieve that ambition.

We believe, like others, that it is timely for the Asian region to advance financial integration by setting up a regional platform for financial transactions, implementing common international financial and business standards, and reducing barriers in domestic markets to foreign institutions including institutional investors. This is not easy to do because it requires broad political agreement and decision and better governance to be in place to attract the private sector. Moreover, it is complicated and it is sometimes beyond the immediate capacity of markets and government to implement effectively.

But these difficulties are not a reason for inaction. The region has a number of forums to talk about, cooperate on, and develop capacity and expertise in, financial and economic issues. These forums have shown that they can provide momentum for discussion of the issues, secure agreement, and deliver capacity building and technical assistance. But they are under-utilised and it would be timely to make more use of them.

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Appendix A: Key International Codes and Standards for Well-Functioning Financial Systems

The Financial Stability Forum (FSF) identifies the various economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems. The international community attaches much importance to the adoption and implementation of these standards because of their beneficial effects on the stability of financial systems both inside countries and globally.

There are twelve key standards which the FSF has designated as deserving of priority implementation, taking account of country circumstances. These cover such areas as:

- Macroeconomic policy and data transparency (including monetary and financial policy transparency and fiscal policy transparency);
- Institutional and market infrastructure (including corporate governance standards, accounting standards, insolvency and market integrity), and
- Financial regulation and supervision (including the areas of banking, insurance and securities).

The standards are not issued by the FSF but by other international bodies such as the IMF, OECD, World Bank, International Accounting Standards Board and the Basel Committee on Banking Standards.

However, adoption of these standards does not mean adherence to a common regulatory regime but, rather, developing a regulatory regime based on the principles embodied in the standards. There is still scope for local requirements to be reflected in each country's regulations and it has never been intended that a 'one size fits all' approach should be adopted.

The Basel Core Principles for banking supervision were originally issued in 1997 by the Basel Committee, operating under the auspices of the Bank for International Settlements. The Core Principles are accompanied by a set of pre-conditions which need to exist to ensure effective supervision. It is recognised that the preconditions are largely beyond the control of the supervisory authority, but will nevertheless have an important bearing on its ability to implement effectively the Core Principles.

These are:

- sound and sustainable macroeconomic policies;
- a well-developed public infrastructure;
- effective market discipline;
- procedures for efficient resolution of problems in banks; and
- mechanisms for providing an appropriate level of systemic protection (or public safety net).

Without the existence of these preconditions the regulatory regime is weakened.

Banks and banking regulators are now moving to adopt a new capital adequacy framework, commonly known as Basel II. The Basel II framework sets out the details for adopting more risk-sensitive minimum capital requirements for banking organisations. The new framework reinforces these risk-sensitive requirements by laying out principles for banks to assess the adequacy of their capital and for supervisors to review such assessments to ensure banks have adequate capital to support their risks.[15] The new standards are expected to operate from 2007, although countries can adopt them at their own speed. Australia, for example, has deferred implementation until 2008.

In addition to forthcoming changes to the banking supervision standards, the Core Principles for Insurance Supervision issued by the International Association of Insurance Supervisors were reissued in October 2003, with quite substantial changes to the previous version.

The International Organisation of Securities Commissions (IOSCO) has published the Objectives and Principles of Securities Regulation which sets out 3 objectives and 30 principles upon which the regulation of securities markets is based.

In addition to thee principles dealing with financial regulation and supervision there are nine other Codes and Standards.

Table A1: Summary of International Codes

Code	**Issuing Body**
Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Code of Good Practices in Fiscal Transparency	IMF
Special Data Dissemination Standard	IMF
General Data Dissemination Standard	
Insolvency	World Bank
Corporate Governance	OECD
International Accounting Standards (known as International Financial Reporting Standards)	International Accounting Standards Board
International Auditing Standards	International Federation of Accountants
Core Principles for Systemically Important Payment Systems	Committee on Payment and Settlement Systems (CPSS)
Recommendations for Securities Settlement Systems	CPSS/IOSCO
Forty Recommendations of the Financial Action Task Force/ Eight Special Recommendations against Terrorist Financing	FATF

[15] Bank for International Settlements, Press Release, 26 June 2004

Appendix B: APEC Projects Related to Financial Issues

Under the auspices of the APEC Finance Minsters' process, the following policy initiatives are currently underway.

1. Voluntary Action Plan for Supporting Freer and More Stable Capital Flows (sponsored by New Zealand and Chile)

Proposed for this initiative is a policy dialogue on savings and the role of the state. The dialogue's objective is to provide an opportunity to exchange views on the role of the state in enabling and providing for structured savings, and the attendant policy and design issues that governments interested in promoting savings need to consider.

2. APEC Finance and Development Program (China and the World Bank)

The Chinese government announced the establishment of an Asia-Pacific Finance and Development Centre (AFDC) to further contribute to capacity building in the region. The three main types of activities carried out under the AFDC are training workshops, a biennial forum and the funding of research projects.

3. Deepening Financial Regulatory Capacity (Australia)

This initiative involves running a life insurance and pensions' capacity building training course, which is intended to take the form of a six day intensive format. The core objectives of the training program are to develop an understanding and awareness of the IAIS Core Principles and their implications for 'best practice' international regulatory approaches; and to expand an understanding of the risks of life insurance and pensions and recognition of the roles and importance of the various stakeholders.

4. APEC Future Economic Leaders' Think Tank (Australia)

The annual Think Tank initiative aims to identify participants who may play a significant future leadership role in their home economies and institutions and to provide and experiential program that facilitates networking, problem-solving and the development of creative solutions for priority regional economic and financial challenges.

5. APEC Financial Regulators Training Initiative (ADB and the United States)

The FRTI advisory groups are chaired by Malaysia. The advisory groups discuss regional training priorities, assess regional training needs and discuss regional cooperation and delivery mechanisms for financial regulator's training. Member economies are encouraged to lodge their training syllabus and training materials on the FRTI website. Training is conducted in the areas of banking supervision and securities regulation. Since 1998, about 1400 junior/mid-level supervisors and regulators have benefited from about 40 regional and national courses.

6. Initiative in APEC Financial Institutions Dealing with SME (Thailand and China)

This initiative involves a dialogue among institutions that deal with SMEs. It reviews cooperative initiatives and has convened a conference with the theme of "Better Environment for Financing, Stronger Development of SMEs"

7. Insolvency Reform Initiative (Australia)

The aim of this initiative is to raise awareness and exchange views on key frameworks for insolvency reform. The initiative will discuss the United Nations Commission on International Trade Law and World Bank guidance on insolvency systems, effective institutional frameworks for insolvency systems and frameworks for cross-border insolvency.

8. Initiative on Financial Reform in the APEC Region (Indonesia and Australia)

The aim of this initiative is to discuss how APEC member economies have developed and implemented reforms to improve their financial sector. Key issues include: how economies are coping with the challenge of carrying out financial reform; prioritisation of the implementation of remaining reforms; and assessing whether there are gaps in expertise and existing capacity building efforts.

9. Fiscal Management Initiative (Vietnam, Indonesia and Australia)

The aim of this initiative is to build on the broad-ranging fiscal policy report to Finance Ministers in 2004 by undertaking a dialogue on a practical issue – the management of significant off-balance sheet risks, such as the contingent liabilities associated with the financing of infrastructure projects or with explicit guarantees to public or private institutions. The extent to which these risks are reflected in government reporting and the potential impact on an economy's overall fiscal position are issues that are important to the sustainability and transparency of fiscal policy.