



<b>Title</b>	<b>Post-Crisis Financial Integration in East Asia</b>
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<b>Citation</b>	<b>Seminar on Hong Kong in the Asia-Pacific Region - Issues and Opportunities, Hong Kong, 23-24 November 2007</b>
<b>Issued Date</b>	<b>2007</b>
<b>URL</b>	<b><a href="http://hdl.handle.net/10722/112747">http://hdl.handle.net/10722/112747</a></b>
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Ten Years After:

Post-crisis Financial Integration in East Asia

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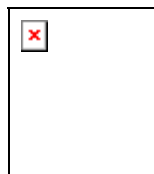
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AIIFL-EAIEL Policy Paper No. 3

November 2007

Asian Institute of International Financial Law (AIIFL)  
and  
East Asian International Economic Law & Policy (EAIEL) Programme

Faculty of Law  
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## **Abstract**

Financial integration is less pronounced in East Asia than among states in Europe and North America, or compared to economic integration within the region. Cross-border trade flows, direct investment and investment in capital goods have long been greater and faster growing than other investment flows, while regional institutional and legal structures are scarce and frequently insubstantive. This dichotomy persists despite suggestions since the early 1990s that Asian financial integration would accelerate, most especially following the East Asian financial crisis of 1997-98, including the growth of regional representative organizations and in national enthusiasm for the World Trade Organization. In particular, it defies post-crisis expectations that greater financial integration might prevent or lessen the impact of future financial shocks. This article suggests explanations in legal, governance and institutional frameworks for the paradox of modest financial integration accompanying robust economic growth and trade integration. First, cultural norms militate against regional innovation in financial markets and systems. Second, other economic institutions have tended to resist market-orientated regional reform. Above all, states failed to collaborate effectively in solutions to regional contagion during and following the 1997-98 financial crisis. Without improving financial integration, Asia will maintain a reliance on risk averse portfolio selection and excessive international reserve accumulation, all to the detriment of its financial markets.

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## I. Introduction

The extent of financial integration among East Asia's emerging and developing economies<sup>1</sup> and Japan matches neither the rhetoric expended in its support after the region's 1997-98 financial crisis nor the degree of regional economic integration. By some measures, it is exceeded by financial integration with Australia, New Zealand and most developed western economies. Cross-border trade flows, direct investment and cross-border investment in capital goods have long been greater and faster growing than other regional capital flows. Regional institutional structures and organizations concerned with finance are scarce and generally insubstantive. The interplay between national and international finance is limited, even among nations with relatively sophisticated financial systems such as South Korea or Singapore. No existing market can be considered regional: Asian intermediaries freely enter global capital market transactions denominated in non-regional currencies but regional markets are underdeveloped and price opaque. This dichotomy persists despite certain developments since the early 1990s that might have encouraged financial integration, and notwithstanding the development of organizations such as the Association of Southeast Asian Nations (ASEAN), which might be expected to favor financial liberalization. It contrasts with financial integration in the European Union (EU), with Asian national enthusiasm for participation in the World Trade Organization (WTO), and with the sophistication of financial intermediation in several Asian centres. Above all, it differs from post-crisis consensus expectations that greater financial integration would help guard against any further shocks or ameliorate their effects.

This article will show how economic, commercial and financial aspects of regional governance in Asia have become manifest in loose transnational organizations and institutions and through "functional cooperation" in national state policy,<sup>2</sup> especially in regional trade policy, dispute resolution, and monetary cooperation. It will suggest that issues of governance help explain why modest financial integration accompanies generally successful economic growth and economic integration. First, long-standing cultural norms and legal systems militate against innovation in

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<sup>1</sup> Emerging economies are taken as undergoing integration into the global financial system; developing economies are those developing domestic financial systems sufficient to permit participation in the global financial system. *See* DOUGLAS ARNER, FINANCIAL STABILITY, ECONOMIC GROWTH AND THE ROLE OF LAW, Ch. 1 (Cambridge University Press, 2007).

<sup>2</sup> *See infra* note 26.

financial markets and systems, insofar as reforms in transnational institutions or organizations would require sacrifices in state autonomy. This has been expressed consistently within regional groups and characterized as the quiescent “ASEAN Way.”<sup>3</sup> This strict preference for consensuality encourages only incremental or pedestrian regional reform. Second, other socio-economic institutions tend to resist the adoption of market-orientated regional solutions, even when they might arise through inter-state cooperation. In particular, national banking systems that dominate saving and credit creation and strong symbiotic relationships between state and banking sector actors tend to slow financial integration, with entrenched interest groups unwilling to compromise their positions in financial governance to countervailing regional institutions or organizations.

The article is directly concerned only with regional financial integration and makes no attempt to address how governance standards affect financial market behavior, for example, by influencing general expectations or asset valuations.<sup>4</sup> Neither does it consider integration between Asia and elsewhere. Unless stated, references in this article to economic or financial integration signify no transnational political objectives. Shortly before the 1957 Treaty of Rome created the European Economic Community (EEC),<sup>5</sup> economic integration was said by an influential libertarian scholar to be “the establishment of a condition which makes possible the free and reciprocal flow of trade between the various national economies”,<sup>6</sup> requiring both free trade in goods and free movement of capital funds.<sup>7</sup> It is appropriate to assess East Asia’s contemporary integration ten years after the East Asian financial crisis with reference to the permissiveness of cross-border regional trade and capital flows.<sup>8</sup>

The following section II reviews the structure of Asian financial integration in relation to issues

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<sup>3</sup> See *infra* note 29.

<sup>4</sup> Financial governance in Asia is the concern of state or commercial actors, and influenced only modestly by external official sources such as regional transnational organizations.

<sup>5</sup> Among Belgium, France, the former West Germany, Italy, Luxembourg and the Netherlands, a group that remained unchanged until 1973.

<sup>6</sup> WILHELM RÖPKE, *Economic Order and International Law*, 86 RECUEIL DES COURS II (1954), at 251.

<sup>7</sup> *Id.* at 252.

<sup>8</sup> Röpke’s description of the European Payments Union (1950-1958) as an arrangement in functional cooperation resembles the ASEAN+3 web of central bank payment lines, see *infra*, sec. IV.B. With the European Coal and Steel Community (1952-2002), this was held to be one of “two great international actions [...] to further Europe’s economic integration,” *Id.* at 258. ASEAN+3 is an ad hoc group comprising ASEAN’s members plus China, Japan and South Korea.

of governance. Section III then identifies factors that help explain the extent of current financial integration, and section IV examines attempts to encourage integration in trade in financial services, cooperation in monetary policy, and capital market development. Section V discusses non-Asian influences, including the WTO's framework for trade in financial services, and asks whether experiences in European financial integration may inform similar developments in Asia more than thought feasible by early theorists of regionalism.<sup>9</sup> Section VI concludes with policy recommendations.

## II. East Asian Financial Cooperation and Governance

Financial integration is associated with capital mobility,<sup>10</sup> and is the extent to which an economy's financial system is not shielded or made distinct from other national and international capital markets. It is thus the antithesis of the Bretton Woods international financial system that prevailed for almost thirty years following World War II.<sup>11</sup> Such integration is difficult to identify consistently,<sup>12</sup> because it can often be quantified only by proxy, and since its use was for long conflated with other forms of integration. The concept is now more carefully considered than before the 1990s, prior to which views as to what integration might mean were undeveloped and reflected a contemporary view that all aspects of finance were subservient to trade or

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<sup>9</sup> Notably Ernst Haas, *see infra* note 37 & note 44.

<sup>10</sup> *See* FRITZ MACHLUP, A HISTORY OF THOUGHT ON ECONOMIC INTEGRATION 71-72 (Macmillan 1977), noting also that "integration" was not used in this sense before the mid-1950s. *Id.* at 13-16. True financial integration in the sense taken here was known in earlier times, *see* Larry Neal, *Integration of International Capital Markets: Quantitative Evidence from the Eighteenth to Twentieth Centuries*, 45 J. ECON. HIST. 2, 219, 221 (1985) (suggesting that the established European equity markets were well-integrated in this sense by the mid-18th century, albeit that there were at the time no state capital controls).

<sup>11</sup> Bretton Woods required the separation of national markets to support fixed exchange rates, independent national monetary policies and general stability, *see* ARNER, *supra* note 1, Ch. 3. One paradox of that system is that it allowed the creation of the offshore regional Eurobond market in the 1960s. Until the mid-1980s the Eurobond market was a permissive institution that relied on the circumvention of national rules. Without a web of national obstructions the market would have been both unnecessary and infeasible. No such regional market exists today in Asia. Recent EU commentary also suggests an analogy between Bretton Woods and Asia's partial regulation:

The experience of the 1930s was interpreted as proof that international capital flows were destabilizing domestic economies. Thus, capital flows were the subject of exchange controls and regulations during the 1950s and 1960s, keeping cross-border financial transactions to a minimum.

*See* THE EU ECONOMY 2003 REVIEW at 320 (European Union, 2003) available at [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/the\\_eu\\_economy\\_review2003\\_en.htm](http://ec.europa.eu/economy_finance/publications/european_economy/the_eu_economy_review2003_en.htm) (accessed Mar. 21, 2007).

<sup>12</sup> APOSTOLOS GKOUTZINIS, *How Far is Basel from Geneva? International Regulatory Convergence and the Elimination of Barriers to International Financial Integration*, SSRN working paper 2006, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=699781](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=699781) (accessed Mar. 21, 2007).

production. Financial integration emphasizes wholesale activity and examines only secondarily those aspects of retail financial intermediation involving individuals.<sup>13</sup> Thus legal or customary borders to the trade in retail financial services prevail even in well-integrated regions such as the European Union.<sup>14</sup>

Financial integration has also been taken to refer to the extent of correlations in price performance of two or more markets or systems, for example in equity securities or interest rates.<sup>15</sup> This is related to the subject of this article only insofar as arbitrage undertaken on the strength of such correlations may involve capital movements of the kind obstructed by Asia's lack of integration. It implies "mobility [of capital] and substitutability among comparable financial assets in terms of yields, maturities and risk in international financial markets"<sup>16</sup> and the expectation of a "full speedy adjustment of asset stocks in response to price changes."<sup>17</sup> Thus true financial integration can be expected to lead to an international convergence of financial asset prices, but the analysis in this article is more closely associated with the needs and preferences of market users. Financial integration is taken to be distinct from integration in commerce, economic policy, monetary policy or political cooperation, however often such policies may be inter-related,<sup>18</sup> and despite relying upon mechanisms commonly identified as

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<sup>13</sup> Wholesale financial market activity is taken to be that conducted among professional, state, official or corporate counterparties, and is generally subject to lower levels of regulatory scrutiny than retail activities.

<sup>14</sup> An early influential EEC study of the benefits of financial integration is CLAUDE SEGRÉ ET AL, *THE DEVELOPMENT OF A EUROPEAN CAPITAL MARKET: REPORT OF A GROUP OF EXPERTS APPOINTED BY THE EEC COMMISSION* (European Economic Community, 1966). Segré lamented the lack of progress in dismantling national barriers to financial activity but plays down the political implications of financial integration. *See infra* sec. V.C. & note 153.

<sup>15</sup> *See e.g.*, JING CHI, KE LI & MARTIN YOUNG, *Financial Integration in East Asian Equity Markets*, 11 *PACIFIC ECON. REV.* 4, 513 (2006); EDUARDO LEVY YEYATI, SERGIO LUIS SCHMUKLER & NEELTJE VAN HOREN, *INTERNATIONAL FINANCIAL INTEGRATION THROUGH THE LAW OF ONE PRICE* (World Bank Policy Research Working Paper No. 3897, 2006). Financial integration is not taken here as that adopted to test asset price or index correlations between national or segmented markets, not least because "price co-movements could reflect common factors and/or similarities in fundamentals, rather than the degree of integration." *See* DAVID COWEN & RANIL SALGADO, *Globalization of Production and Financial Integration in Asia*, in *FINANCIAL INTEGRATION IN ASIA: RECENT DEVELOPMENTS AND NEXT STEPS* (David Cowen, Ranil Salgado, Hemant Shah, Leslie Teo & Alessandro Zanello, eds., IMF WORKING PAPER No. 06/196, 2006).

<sup>16</sup> WILLIAM SHEPHERD, *INTERNATIONAL FINANCIAL INTEGRATION: HISTORY, THEORY AND APPLICATIONS IN OECD COUNTRIES 77-79* (Aldershot, 1994). But note that "substitutability" today would include synthetic transactions such as offshore non-deliverable derivative contracts, the existence of which implies extant capital controls or other barriers to financial integration.

<sup>17</sup> *Id.* at 78.

<sup>18</sup> Integration in commercial or economic policy refers to arrangements for trade and foreign direct investment; monetary integration refers to formal currency cooperation; political integration involves deliberate sharing of national sovereignty.



political.<sup>19</sup>

The premise of this article is that Asian financial integration is modest, even though cross-border acquisitions, joint ventures and other forms of regional cross-border investment are well-established and require substantial transfers of funding or capital goods. A recent study published by the International Monetary Fund (IMF) found that:

[T]otal financial liabilities in Asia (the combined stock of foreign direct investment (FDI), foreign loans, and equity holdings) is typically lower than in other regions of the world. Moreover, intraregional financial integration — for example, measured directly by cross-border capital flows or indirectly by cross-border correlation of consumption growth — has been more limited than elsewhere. Consequently, Asian economies appear to have become more integrated with countries outside the region than within the region.<sup>20</sup>

Evidence of a direct relationship between financial integration and economic growth is inconclusive.<sup>21</sup> This is significant in terms of state norms in Asia, given that capital controls

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<sup>19</sup> But which may arise from economic factors such as incentives to political action. For a description of four major such mechanisms see COLIN BENNETT, *What Is Policy Convergence and What Causes It?*, 21 BRIT. J. POL. SCI. 2, 215 (1991), identifying policy emulation, harmonization, penetration and the existence of elite policy groups. See also *infra* sec. III.D.

<sup>20</sup> See GRACIELA KAMINSKY & MARCO CIPRIANI, A NEW ERA OF INTERNATIONAL FINANCIAL INTEGRATION: GLOBAL, MARKET, AND REGIONAL FACTORS (Hong Kong University School of Economics & Finance Workshop Discussion Paper No. 534, 2006); Cowen & Salgado, *see supra* note 15, at 11 (suggesting that:

the region generates substantial net saving [...] and countries have been accumulating large stocks of foreign reserves. This has resulted in the financial sectors of developed countries in Europe and North America serving as financial intermediaries for the Asian economies, with relatively more stable outbound official flows and more volatile inbound private flows.)

If high Asian net national saving was induced partly by the financial crisis, and such saving implies lesser financial integration, it is less clear why the accumulation of reserves has continued despite a steady recovery in Asian sovereign credit ratings since 2000, but seems to suggest how profound was the crisis. See *infra* sec. III.B.

<sup>21</sup> See MORITZ SCHULARICK & THOMAS STEGER, DOES FINANCIAL INTEGRATION SPUR ECONOMIC GROWTH? NEW EVIDENCE FROM THE FIRST ERA OF FINANCIAL GLOBALIZATION (CESIFO Working Paper No. 1691, 2006), available at <http://www.ssrn.com/abstract=884434> (accessed Mar. 21, 2007), suggesting that developmental benefits associated with financial integration require prior domestic institutional reform, in particular the maintenance of adequate and enforceable property rights. The indeterminate result may signify problems in the empirical specification of financial integration, which is most commonly observed in the ratio of capital flows, or holdings of foreign assets and liabilities, to national income, or represented by a binary indicator for cross-border capital controls. See also PHILIP LANE & GIAN MARIA MILESI-FERRETTI, INTERNATIONAL FINANCIAL INTEGRATION (IMF Working Paper No. WP/03/86, 2003) (using an index based on the sum of foreign assets and liabilities to national income). This is contextually important in that if modest financial integration is linked to high net national savings, then the disutility of reserve accumulation is compounded by developmental effects. See PHILIP LANE & SERGIO SCHMUKLER, *The International Financial Integration of China and India*, INSTITUTE FOR INTERNATIONAL

were anathema to the IMF from at least the mid-1980s until they became controversial in the wake of the 1997-98 financial crisis.<sup>22</sup> Since then, capital controls have been more widely favored, partly due to their use by states such as China and Malaysia that were relatively lightly affected by the crisis.<sup>23</sup>

Concepts of governance often abstract from thin material. While governance has been taken to involve a proactive state “sustaining coordination and coherence among a wide variety of actors”<sup>24</sup> that might include transnational organizations, it may also represent the “empirical manifestations of state adaptation to its external environment” or alternatively “a theoretical representation of coordination of social systems”<sup>25</sup> by the state and others. Such conceptual inclusiveness allows a discussion of whatever governance that is manifested through East Asian regional financial integration to include instances where none exists, that is, an absence of governance analogous to the view of Asian regionalism as a form of “pre-governance,”<sup>26</sup> and the roles taken by non-state commercial actors, especially from the financial sector. The most appropriate approach for this analysis may be to regard governance as “[t]he processes and institutions, both formal and informal, that guide and restrain the collective activities of a group.”<sup>27</sup> Weakness in these processes and institutions reflect an absence of regional governance.

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INTEGRATION STUDIES DISCUSSION PAPER NO. 174 (2006), available at <http://ssrn.com/abstract=925872> (accessed Mar. 21, 2007).

<sup>22</sup> During the 1990s the IMF and World Bank advocated and when possible demanded that developing states follow free market policies, characterized as the “Washington Consensus”, see JOHN WILLIAMSON, *What Washington Means by Policy Reform*, in JOHN WILLIAMSON (ed.), *LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?* Ch. 2 (Institute for International Economics, 1990). Williamson later recanted part of the consensus relating to financial integration, arguing that “the policies these institutions advocated in the 1990s were inimical to the cause of poverty reduction in emerging markets in at least one respect: their advocacy of capital account liberalization.” JOHN WILLIAMSON, *What Should the World Bank Think about the Washington Consensus?*, 15 *WORLD BANK RES. OBSERVER* 2, 257 (2000).

<sup>23</sup> China has maintained extensive capital controls throughout a period of relatively rapid growth in national income since the late 1970s. Malaysia’s less comprehensive restrictions on the withdrawal of foreign capital may have helped its economy and financial markets suffer less severely in the Asian financial crisis and recover more rapidly thereafter. *See also* *infra* sec. III.A.

<sup>24</sup> JON PIERRE, *Introduction*, in *DEBATING GOVERNANCE* 3 (Jon Pierre, ed., Oxford University Press, 2000).

<sup>25</sup> *Id.*

<sup>26</sup> ANTHONY PAYNE, *Globalization and Regionalist Governance*, in *DEBATING GOVERNANCE*, *supra* note 24, at 214-215.

<sup>27</sup> ROBERT KEOHANE & JOSEPH NYE, *Governance in a Globalizing World*, in *GOVERNANCE IN A GLOBALIZING WORLD* 12 (Joseph Nye & John Donahue, eds., Brookings Institution, 2000).

That Asia's financial integration lags its considerable economic integration may appear inconsistent with the sophistication of certain of its domestic financial systems. The explanation may result from the influence of cultural norms operating at state and sub-state level that, as sections III and IV will show, govern behavior within Asia's regional institutions and organizations. This influence is manifest in an elective aspect of state governance, that is, the primacy of certain national economic policies with which regional financial integration is commonly deemed inconsistent. Such norms are comprehensively represented by the "ASEAN Way," stemming from ASEAN's founding declaration and succeeding first treaty,<sup>28</sup> and involving consensual decision-making and commitments to mutual non-interference by member states. It was characterized during the 1997-98 financial crisis by Singapore's foreign minister as stressing "informality, organizational minimalism, inclusiveness, intensive consultations leading to consensus, and peaceful resolution, of disputes."<sup>29</sup>

The nature of financial governance in Asia as revealed in the behavior of its regional organizations and institutions is thus the result of weak regional norms competing with paramount national policy. Today's limited financial integration may be regarded as having been achieved in spite of such norms.<sup>30</sup>

Founded in 1967, ASEAN has become the most conspicuous organization associated with Asian regionalism. This reflects both a growing disutility of APEC (the Asia Pacific Economic Cooperation Forum),<sup>31</sup> and ASEAN's embracing China, Japan and South Korea, the dominant economies of Northeast Asia, through the ASEAN+3 mechanism. Throughout this article, ASEAN and ASEAN+3 are referred to as organizations or as the products of institutional arrangements since their existence is real when measured by actions or norms. It is less clear in

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<sup>28</sup> See respectively The ASEAN Declaration, 1967, available at <http://www.aseansec.org/1212.htm> (accessed Mar. 21, 2007), & Treaty of Amity and Cooperation in Southeast Asia, 1976, available at <http://www.aseansec.org/1217.htm> (accessed Mar. 21, 2007).

<sup>29</sup> Shanmugam Jayakumar, "Stick to Basics" (speech to ASEAN ministerial meeting, Jul. 24, 1998), available at <http://www.aseansec.org/3924.htm> (accessed Mar. 21, 2007). See also AMITAV ACHARYA, *The Evolution of ASEAN Norms and the Emergence of the ASEAN Way* at 47-70 in AMITAV ACHARYA, *CONSTRUCTING A SECURITY COMMUNITY IN SOUTHEAST ASIA: ASEAN AND THE PROBLEM OF REGIONAL ORDER* (Routledge, 2001).

<sup>30</sup> Most of the regional groupings formed up to 2005 in Asia are listed in *ADVANCING EAST ASIAN REGIONALISM* 247-254 (Melissa Curley & Nicholas Thomas, eds., Routledge, 2007).

<sup>31</sup> See notably JOHN RAVENHILL, *APEC AND THE CONSTRUCTION OF PACIFIC RIM REGIONALISM* (Cambridge University Press, 2001).

law that either body represents at a non-trivial level more than an association of states without legal personality.<sup>32</sup> For example, when ASEAN chooses to make substantive agreements with third parties, for example in relation to trade with a non-ASEAN state such as China, then each state (ASEAN and non-ASEAN) would enter a separate treaty. ASEAN is more an expression of aims than a substantive, constitutionally formed body. This “soft” personality intentionally constrains its capacity in regional governance.

ASEAN was for long unconcerned with the financial sector but began discussing regional financial matters in the mid-1990s.<sup>33</sup> This was influenced by the 1997-98 financial crisis, a consensual wish to see the region distinguished from elsewhere, and a surge in the growth of trade with China and cross-border direct investment to China from ASEAN members. In 1995, ASEAN’s heads of governments declared that it:

shall move towards greater economic integration by building on existing economic cooperation activities, initiating new areas of cooperation, and promoting closer cooperation in international fora.<sup>34</sup>

ASEAN’s first venture in financial cooperation was a cooperative framework among national bodies for banking, capital markets, customs, insurance, taxation, and related human resources, ironically made immediately prior to the financial crisis in early 1997.<sup>35</sup> This protocol encourages members to discuss macroeconomic and regulatory policies, improve policy and regulatory transparency, and promote links between the public and private sectors. The agreement was made subject to ASEAN’s consensual approach with the proviso that two or more members might engage in the implementation of programs and projects at their chosen pace

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<sup>32</sup> A proposal for ASEAN to assume a legal personality was to have been discussed at a postponed 2006 heads of state summit in January 2007, upon the recommendation of an ASEAN “Eminent Persons” study convened as part of a 2005 initiative named Vision 2020 to revise ASEAN’s charter. It is thought that ASEAN leaders may now discuss the proposal in late 2007.

<sup>33</sup> Indeed, no aspect of finance is among ASEAN’s current “Priority Sectors for Economic Integration” comprising 12 industrial and service sectors, see [http://www.aseansec.org/Fact\\_Sheet/AEC/2007-AEC-002.pdf](http://www.aseansec.org/Fact_Sheet/AEC/2007-AEC-002.pdf) (accessed Mar. 21, 2007). Similarly, no mention of finance was made at the most recent ASEAN economic ministers meeting in August 2006. That ASEAN members elect to keep finance under local control may also reflect a perceived competitive disadvantage against global financial intermediaries.

<sup>34</sup> The Bangkok Summit Declaration of 1995, available at <http://www.aseansec.org/5189.htm> (accessed Mar. 21, 2007).

<sup>35</sup> Ministerial Understanding on ASEAN Cooperation in Finance, available at <http://www.aseansec.org/1939.htm> (accessed Mar. 21, 2007).

rather than be restrained by others.<sup>36</sup> The qualification is less an advance in regional governance than acknowledgement that financially underdeveloped states may lack the means or wish to engage in joint policies. Wholly new initiatives must be sanctioned by all members. The activities to which the states are urged to participate are stated briefly and without the “functional specificity” that one leading early theorist of regionalism considered as “causally related to the intensity of integration.”<sup>37</sup> The intention was rehearsed at the peak of the Asian financial crisis in December 1997 when, in a forward looking statement, ASEAN heads of government undertook to:

promote financial sector liberalization and closer cooperation in money and capital market [sic.], tax, insurance and customs matters as well as closer consultations in macroeconomic and financial policies.<sup>38</sup>

More generally, ASEAN and ASEAN+3 states have been unprepared to relinquish the high degree of national policy control that is a corollary of weak or non-existent regional institutions and organizations. This may be distinguished from an absence of regional governance similar to the concept of “pre-governance”<sup>39</sup> inasmuch as it represents deliberate choice rather than a formative period that tends to induce greater regional governance. It includes effective authority in governance given to certain non-state actors, especially in national banking sectors. Thus the extent of regional integration may be thought consistent with shared norms, whether deliberately adopted, as with the consensuality and mutual non-interference of the ASEAN Way and of making paramount other aspects of state policy, or indirect, such as the pivotal role in governance of commercial and banking interests. The organization of Asian capitalism in the developmental state model has been effective serially in Japan, South Korea and China in this respect, characterized by close directional relationships between the state and leading commercial interests.<sup>40</sup> It has been asserted that:

authority structures in the Asia Pacific serve the interests of dominant actors and statebusiness [sic.] coalitions, and that these actors are organized into informal networks of power, that is, particular informal modes of regional governance,

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<sup>36</sup> Id., art. 5.

<sup>37</sup> ERNST HAAS, *International Integration: The European and the Universal Process*, 15 INT. ORGAN. 3, 372 (1961).

<sup>38</sup> ASEAN Vision 2020, 1997, available at <http://www.aseansec.org/1814.htm> (accessed Mar. 21, 2007).

<sup>39</sup> See PAYNE, *supra* note 26.

<sup>40</sup> See especially S. GORDON REDDING, *THE SPIRIT OF CHINESE CAPITALISM* (W. de Gruyter, 1990).

serving private as well as public interests.<sup>41</sup>

This institutional involvement of non-state actors in Asian governance is distinct from the more general proposition that international economic activities of all non-state participants may contribute to governance.<sup>42</sup>

The most dramatic subsuming of regionalism to national policy objectives is seen in the region's accumulation of international reserves since 2000, partly a consequence of the primacy of national exchange rate policy over financial integration and regional market development. The shared commitments and policies implicit in financial regionalism are constrained by national objectives.<sup>43</sup> The relative forcefulness of national policy has long been recognized in the context of regional integration:

Organizations with an economic mandate short of creating a common market or free trade area have great difficulty in influencing the policies of their members.<sup>44</sup>

Yet most states adopted similar national post-crisis policies and risk averse asset accumulation that would appear to be conducive to cooperation. While a relatively modest degree of integration might impact on existing arrangements for governance, it seems that greater connectivity and interdependence among both Asian states and sub-state participants does not signify greater financial integration. Regional institutions and organizations require shared objectives among their founders, as well as mutual interdependence.<sup>45</sup>

### **III. Factors Encouraging Financial Cooperation and Integration**

Four factors have encouraged discussions and initiatives concerning Asian financial cooperation, integration and governance in the last decade. These relate especially to the 1997-98 financial crisis, but also to growing economic integration, developmental issues, and certain political

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<sup>41</sup> FREDRIK SODERBAUM, *Modes of Regional Governance in Africa: Neoliberalism, Sovereignty Boosting, and Shadow Networks*, 10 GLOBAL GOVERNANCE 419-436 (2004).

<sup>42</sup> JOSEPH NYE & ROBERT KEOHANE, *Transnational Relations and World Politics: an Introduction*, 25 INT. ORGAN. 3, 329-349 (1971). *See also infra* sec. V.C.

<sup>43</sup> This is illustrated by the portion of ASEAN+3 international reserves pooled in a regional integration initiative representing only 0.15 percent of the total when created at end-2005, *see infra* sec. IV.C.1.

<sup>44</sup> ERNST HAAS, *The Study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing*, 24 (4) INT. ORGAN. 616 (1970).

<sup>45</sup> ROBERT KEOHANE, *From Interdependence and Institutions to Globalization and Governance*, in POWER AND GOVERNANCE IN A PARTIALLY GLOBALIZED WORLD 1-23 (Routledge, 2002).

influences. The means by which these factors encouraged integration are relevant to the policy formation processes customarily used by Asia's regional bodies.

### **A. Crisis Imperatives**

The 1997-98 financial crisis has had an enduring impact on national economies and the approach to policy formation. The economic and social dislocation provoked in South Korea and Southeast Asia by the dissipation of market confidence produced a concern among state actors that Asia lacked national and regional crisis remedies, since only non-Asian organizations such as the IMF were able to provide credit infusions sufficient to stem the draining of external resources. The view was most clearly voiced within ASEAN and by Japan.<sup>46</sup> The crisis also induced a lasting risk aversion among policymakers fearful of similar instability. While this disposition initially helped induce limited financial reforms in individual economies, it has also prevented the introduction of significant regional solutions that might involve financial integration.

A further controversy arose soon after the crisis in the appraisal of external capital controls. China and Malaysia maintained or introduced over this period barriers to the free movement of capital, contrary to the customary advice of transnational organizations and to which neither took heed. Each suffered less material falls in output and financial asset values after 1997-98, while the crisis was most severe in its impact on states such as Indonesia, South Korea and Thailand that had minimal controls on capital inflows.<sup>47</sup> This is not to imply simple causation from capital mobility to external vulnerability, but these examples were sufficient to encourage other states to see the policies of the Washington Consensus as deleterious to recovery,<sup>48</sup> and gave weight to national norms at the expense of a more regional orientation. It is clear that financial integration as indicated by capital mobility is entombed for regional policymakers as a condition that contributed to the financial crisis and the contagion that made its effects so severe. Such

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<sup>46</sup> And induced officials in Japan to propose certain new regional institutions, including an Asian Monetary Fund, *see* SHIGEKO HAYASHI, *JAPAN AND EAST ASIAN MONETARY REGIONALISM: TOWARDS A PROACTIVE LEADERSHIP ROLE* 82-102 (Routledge, 2006).

<sup>47</sup> China's post-crisis economic and financial experience may also have been protected by a substantial currency devaluation in 1994.

<sup>48</sup> *See supra* note 22. *See also* ASLI DEMIRGÜÇ-KUNT & ENRICA DETRAGIACHE, *FINANCIAL LIBERALIZATION AND FINANCIAL FRAGILITY* 12 (World Bank Working Paper No. 1917, 1998), available at <http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1900series/wps1917/wps1917.pdf> (accessed Mar. 21, 2007).

integration has therefore been a low priority for ASEAN+3 actors.

The crisis exposed helplessness within Asia's regional organizations. This reflected the scale of its severity, as well as limited prior attention to regional financial structure and resources. In 1997 no Asian organization was able to provide support to any state, however temporarily, leading to the irony that Indonesia, South Korea and Thailand faced an invasiveness towards national policymaking, especially through credit conditions, that were contrary to all ASEAN precepts. Short-term IMF credit was essential but given on output-reducing terms and without concern for non-interference in state governance. Thailand first sought liquidity assistance from Japan in early 1997 but no mechanism existed to allow meaningful support, and neither Japan nor the United States wished to abandon the conditionality of funding associated with IMF programs, not least to preserve their own influence and advance their own interests. This impasse led to suggestions for new regional institutions to address similar problems, notably in Japan's proposals for an Asian Monetary Fund as an alternative to the IMF, but the initiative was unsuccessful and subsequent policy discussions on these issues have been consistently impeded by the United States whenever possible.<sup>49</sup>

Thus the crisis not only revealed weaknesses in national financial systems, but also in imperfect and entrenched regional economic and financial linkages that made every domestic economy vulnerable to contagion from systemic shocks. Its aftermath produced discrete national reforms intended to bolster recovery and improve crisis avoidance. These sought to improve the effectiveness of national financial systems and alter the extent of state involvement in finance, but with the exception of South Korea and Malaysia, most changes were modest, especially in legal and regulatory systems. State influence persists in individual financial sectors and the burgeoning results of currency management have diluted the incentives for domestic or regional financial reform.

Finally, the crisis induced the only known attempt to relax ASEAN's doctrine of mutual non-interference: Thailand proposed in 1997-98 a policy of "flexible engagement" to signify deliberate interaction among member states. The requirements and implications were not fully

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<sup>49</sup> A narrative of Japan's policy response to the financial crisis appears in HAYASHI, *supra* note 46, at 82-102.



developed but it was clear that the change recognized that ASEAN members faced a common assault in the form of rapidly depreciating currencies and the withdrawal of international credit that might be better resisted through cooperation more advanced than that contemplated by ASEAN precepts. The proposal received minimal support and was abandoned as unworkable. The consensus that rejected flexible engagement in 1998 was described as:

the vision of ASEAN 2020 in which there will be a free flow of goods, services and investments, a *freer* flow of capital,<sup>50</sup> equitable economic development and reduced poverty and socioeconomic disparities. This closer economic integration will be achieved, among other strategies, by fully implementing [the ASEAN Free Trade Area].<sup>51</sup>

The suggestion that capital mobility might eventually be freer acknowledges the limits that members set for financial integration. Nothing in these remarks addresses the usefulness of Asia's regional institutions in times of crisis. It is implicit in the stance that ASEAN will not engage in financial rule-making. With ASEAN+3 steadily superseding ASEAN in high-level policy formation, the chances are slender that flexible engagement will revive, given China's adherence to the existing approach and an ongoing nationalistic hiatus in Thailand.<sup>52</sup>

## **B. Economic Influences**

In the absence of national restrictions, expanding trade and investment might be expected to increase the demand for financial instruments and their scope of use, for example, in trade finance, direct investment funding (including in support of mergers and acquisitions), and requirements for banking, treasury or cash management products. While many Asian public and private sector users have access to sophisticated financial instruments and applications in international markets and major currencies, the extent of such activity within the region or denominated in local currencies is materially lower than suggested by those flows of trade and investment. This is the most apparent systemic result of relatively undeveloped financial integration. Unsatisfied demand for financial instruments and systems associated with economic

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<sup>50</sup> Emphasis added.

<sup>51</sup> Jayakumar, *supra* note 29.

<sup>52</sup> Notwithstanding the common objectives expressed in ASEAN's Vision 2020, *see supra* note 32.

integration highlights an array of impediments to regional and national financial activity.<sup>53</sup> Section IV outlines initiatives that have addressed certain such impediments, none yet with full success. Many problems remain at national level for which a consensus on regional reform could be valuable.

### **C. Developmental Issues**

Part of Asia's post-2000 crisis response has been the precautionary acquisition of non-Asian financial assets, which is closely connected to national currency management over the same period. Thus state actors now control very substantial foreign reserves but the scale of their accumulation has prompted concerns as to risk concentration, and whether a portion of those resources might be allocated to Asian assets and support for welfare or infrastructural development. Furthermore, most Asian economies have comparatively high rates of precautionary savings. Individuals tend to hold much of their savings as deposits, and high bank liquidity has often been associated with poor credit risk assessment or indiscriminate or directed lending. A development imperative thus focuses on allowing deeper and more transparent financial markets to allow broader uses of foreign reserves within the region and apply domestic savings better to support capital investment. High profile examples include the growing trend of government investment corporations, modeled on Singaporean and Gulf state experiences. Applying resources in support of regional development is distinct from the issue of encouraging development through crisis avoidance.

### **D. Political Factors**

Politics is so pervasive an influence on the extent and character of financial integration as to drive it beyond the direct scope of this article. Both the relative competitive position of states and their historic rivalries are highly significant in discussions on regional integration. Currently, the growing influence of China is arguably encouraging smaller states (and to some extent Japan as well) to favor enhanced mutual cooperation for protective reasons, including through balancing

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<sup>53</sup> For example, restrictions on non-residents holding money market instruments, *see* DOUGLAS ARNER, PAUL LEJOT & S. GHON RHEE, IMPEDIMENTS TO CROSS-BORDER INVESTMENTS IN ASIAN BONDS (Institute of Southeast Asian Studies, 2006).

by involving ASEAN+6 states (India, Australia, New Zealand). Similar thinking argues the need to offset the political-economic weight of the European Union and United States and their respective currency areas. Discussions of economic and financial cooperation and integration and governance issues between ASEAN and ASEAN+3 actors are significantly impacted by both arguments, with ASEAN+6 discussions a direct result. At the same time, such efforts may be dispelled by the increasing number of bilateral trade agreements within the region, notwithstanding the constructive view that Asia's "noodle bowl" network of such bilateral trade agreements may be building blocks for universal free trade.<sup>54</sup>

Other external pressures from the European Union and United States have prevented ASEAN from acting collectively, for example in representations on its admission of Myanmar, and in the response to Japanese post-crisis regional initiatives.<sup>55</sup> More constructive political forces may arise in security cooperation, seen recently as one of "three pillars" that might support more intense Asian political integration,<sup>56</sup> and it has been argued that ASEAN "has generated significant benefits in the form of confidence-building activities even though the gains from economic collaboration have been minimal"<sup>57</sup> with such benefits apparent in political and security matters.

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<sup>54</sup> RICHARD BALDWIN, MULTILATERALISING REGIONALISM: SPAGHETTI BOWLS AS BUILDING BLOCS ON THE PATH TO GLOBAL FREE TRADE (NBER Working Paper No. 12545, 2006), available at <http://www.nber.org/papers/w12545> (accessed Mar. 21, 2007). The same author has written about inherent weaknesses of Asian regional gatherings and organizations in economic integration, because

The fragility of the East Asian [trade] system stems from the extreme interdependence of nations' competitiveness, the lack of WTO discipline, and the lack of top-level [regional organizational or institutional] management [to substitute for WTO discipline].

RICHARD BALDWIN, *Managing the Noodle Bowl: The Fragility of East Asian Regionalism*, at 2, CEPR DISCUSSION PAPER NO. 5561 (2006), available at <http://www.ssrn.com/abstract=912265> (accessed Mar. 21, 2007).

<sup>55</sup> See *supra* sec. III.A. An alternative view is that Japan has "limited incentives to invest in regional cooperation," see NATASHA HAMILTON-HART, FINANCIAL COOPERATION AND POLITICAL ECONOMY at 132 in CURLEY & THOMAS, ADVANCING EAST ASIAN REGIONALISM, *supra* note 30, due to its having "an economy still much more domestically orientated than that [sic.] of its neighbours," *id.*, and since Japanese cooperation proposals (such as those for monetary cooperation or an Asian monetary fund) stems from "relatively insulated policy-makers and academics" who lack support at home. *Id.* However insulated may be the root of such proposals, this seems a mischaracterization of the scale of the Japanese external sector based upon its size relative to other far smaller Asian economies, and neglects the interest of Japan's commercial interests in advancing all forms of regional financial integration.

<sup>56</sup> MELISSA CURLEY & NICHOLAS THOMAS, *Introduction* at 17-19 in CURLEY & THOMAS, ADVANCING EAST ASIAN REGIONALISM, *supra* note 30.

<sup>57</sup> See e.g., RAVENHILL, *supra* note 31, at 27; EVELYN GOH & AMITAV ACHARYA, *The ASEAN Regional Forum and Security Regionalism: Comparing Chinese and American Positions*, in ADVANCING EAST ASIAN REGIONALISM, *supra* note 30, at 96-115.

## **E. Transmission Mechanisms**

Convergence in economic policy formation and outcomes of the type identified as financial integration require incentives and workable transmission channels. One such non-exhaustive characterization suggests four distinct mechanisms through which convergence among states is made effective, namely policy emulation, harmonization, penetration and the existence of elite policy groups,<sup>58</sup> against which regional channels can be seen to be comparatively weak.

## **IV. Financial Integration and Development Initiatives**

Asian financial integration has been subject to considerable but equivocal attention, reflecting the paradox described in section II that financial integration lags economic integration. Here, the region's transnational organizations are important for two reasons. First, they represent extant regional institutions and their limitations illustrate an uncommitted approach to regional governance; second, they have supported national actors with funding and technical assistance for financial reform. Initiatives to encourage financial integration have in particular addressed trade in financial services, cooperation in external monetary operations, or capital market reform.<sup>59</sup>

There is no single view as to whether Asian financial development is more appropriately directed at domestic or regional issues. The Washington Consensus traditionally saw domestic market development as contributing a greater benefit in utility and crisis prevention, and suggested that regional development is secondary. Asian policymakers may be more malleable but the historical result of such differences has been for reform to arise in the forum of least resistance. Thus ASEAN+3 has addressed regional development issues to which the United States was opposed while APEC dealt with proposals that the United States might endorse, including domestic market development. In the second case, post-crisis proposals were developed in APEC and the Asian Development Bank (ADB) to establish a well-capitalized regional financial guarantor to provide credit enhancement for structured transactions but lapsed due to opposition of non-Asian

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<sup>58</sup> See BENNETT, *supra* note 19.

<sup>59</sup> Japan's strategies for financial cooperation including reforming taxation through a web of new treaties are beyond the scope of this analysis.

participants or ADB shareholders.<sup>60</sup> This article's view is that both domestic and regional approaches to reform have value and may be mutually reinforcing.

## **A. Trade in Financial Services**

Limited growth has occurred in regional trade in financial services and an improvement is likely to occur only slowly. This sub-section discusses cooperation in financial services liberalization, the structure of the ASEAN Free Trade Area (AFTA) and APEC's interest in an international framework for financial services liberalization. It also examines one aspect of a proposed Asian Economic Community (often labeled ASEAN+6) embracing ASEAN+3, Australia, India and New Zealand, that may become a framework for wider cooperation. It does so in the context of governance issues and does not test the extent of AFTA usage, or tariffs and non-tariff barriers maintained for declared reasons of national interest.<sup>61</sup>

### **1. AFTA**

ASEAN activity includes heads of government summits, ministerial meetings and work in ad hoc committees. The organization has never been prominent in economic affairs, although persistence has helped inculcate a positive image as a collaborative forum. ASEAN finance ministers first met to discuss regional cooperation in 1967.<sup>62</sup> Substantive cooperation was minimal for some years but in 1995 ASEAN's heads of governments declared that it:

shall move towards greater economic integration by building on existing economic cooperation activities, initiating new areas of cooperation, and promoting closer cooperation in international fora.<sup>63</sup>

Developmental diversity and differences in economic systems hinder effective collaboration, especially in the larger ASEAN+3 group, despite which ASEAN may have assumed a more significant role in economic regionalism since the Asian crisis, influenced also by European and North American economic regionalism and the re-emerging force of China's economy.

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<sup>60</sup> ASEAN+3 also failed to support the proposal, *see supra* sec. II. Note that a regional guarantor would have competed with commercial monoline insurers, most of which are US domiciled.

<sup>61</sup> Entrenched state protectionism will limit the use of AFTA agreements, *see* BALDWIN, *supra* note 54 at 36-37.

<sup>62</sup> Producing the Ministerial Understanding on ASEAN Cooperation in Finance, *see supra* sec. II & note 35.

<sup>63</sup> Bangkok Summit Declaration of 1995, *supra* note 35.

Any conceptual success in AFTA obscures institutional problems compared to more mature regional trade organizations. It is administered by neither rule nor principle, and maintains an informal orientation that emphasizes consultation rather than judicial procedure or settlement. This makes AFTA non-cohesive rather than rigorous or integrated. AFTA began in 1992 as part of a wider ASEAN protocol on economic cooperation,<sup>64</sup> the breadth of language of which makes it doubtful that it constitutes a treaty among signatories.<sup>65</sup> AFTA's substantive initiating agreement sets objectives for removing tariffs and non-tariff barriers,<sup>66</sup> and later modifications have made the elimination of all import duties by 2015 a goal.<sup>67</sup> Similar objectives have been adopted within ASEAN+3 and thus China-ASEAN, South Korea-ASEAN and Japan-ASEAN free trade areas are all in the process of formation.<sup>68</sup>

## 2. AFAS Financial Services Sector Commitments

ASEAN's 1995 Framework Agreement on Services (AFAS)<sup>69</sup> seeks to reduce barriers to trade in services, requiring members to negotiate to lift restrictions in specific market segments and to some degree expand upon their commitments under the WTO's General Agreement on Trade in Services (GATS), discussed further in section V. The commitments are not confined to allowing foreign access only to ASEAN members. The following table summarizes ASEAN financial services market access commitments under the ASEAN framework.

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<sup>64</sup> AFTA appears in only one 15 clauses of the Framework Agreement on Enhancing ASEAN Economic Cooperation, 1992, available at <http://www.aseansec.org/12374.htm> (accessed Mar. 21, 2007).

<sup>65</sup> JACQUES PELKMANS, *ASEAN and APEC, A Triumph of the 'Asian Way'?* in REGIONALISM AND MULTILATERALISM AFTER THE URUGUAY ROUND: CONVERGENCE, DIVERGENCE AND INTERACTION 211 (Paul Demaret, Jean-Francois Bellis & Gonzalo Garcia Jimenez, eds., European Inter-University Press, 1997).

<sup>66</sup> Agreement on the Common Effective Preferential Tariff Scheme for AFTA, 1995, available at <http://www.aseansec.org/12375.htm> (accessed Mar. 21, 2007).

<sup>67</sup> Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand intend do so by 2010. However, all members may unilaterally retain tariffs on goods they deem sensitive to national interests.

<sup>68</sup> See also BALDWIN, *supra* note 54.

<sup>69</sup> 1995, available at <http://www.aseansec.org/6628.htm> (accessed Mar. 21, 2007), art. IV. Certain financial sector requirements commitments were strengthened in 2002-03: Protocol to Amend the ASEAN Financial Services Agreement, available at [http://www.aseansec.org/AFAS\\_Amendment\\_Protocol.pdf](http://www.aseansec.org/AFAS_Amendment_Protocol.pdf) (accessed Mar. 21, 2007).

Table 1: ASEAN Financial Services Sector Commitments

	Market segment	limits to foreign investment
Brunei	Financial advisory and ancillary services	Official approval required
Cambodia	Insurance and retrocession	Official approval required
	Lending and deposit-taking	Permitted through licensed intermediaries
	Life and non-life insurance	Natural or juridical persons may enter contracts only with licensed insurance companies in Cambodia
	Reinsurance and retrocession	Companies must reinsure 20% of their risk with state reinsurer Cambodian Re until end-2008
Indonesia	All payment and monetary transmission services	Permitted through authorized financial institutions as banks
	Guarantees and commitments	Not proscribed until related law is established
Laos	Commercial banking business	Limited to two sub-branches and two auxiliary offices for foreign banks and two sub branches for joint venture banks
Laos	Insurance	Authorized insurance companies must trade through a corporate entity with a minimum registered capital and a parent guarantee lodged with a bank resident in Laos
	Financial leasing, payment and money transmission services	No limit
	Securities, money broking, settlement and clearing services, advisory and auxiliary financial services	Unlimited until a related law is established
Malaysia	Insurance	Foreign shareholding not to exceed 30 percent.
	Advisory, intermediation and other auxiliary financial services	Investment advice requires a physical commercial presence; other services must be jointly undertaken with commercial banks or merchant banks in Malaysia
Myanmar	Loss adjustment	No restriction
	Actuarial services	No limits
Philippines	Insurance, reinsurance and ancillary insurance	Foreign interests may control 60 percent of domestic insurers (40 percent of ancillary insurance ventures); no more than one third of directors may be foreign nationals.
	Broker-dealer	Permitted as foreign equity participation in domestic corporations or a branch office. Prior registration required for broker-dealers; Foreign broker-dealers limited to two branches
Singapore	Insurance	Foreign interests may control 49 percent of domestic insurers; no restrictions on new insurance licenses and representative offices.

	Securities	Bank and merchant bank exchange membership must be held through subsidiaries
Thailand	Lending and deposit-taking; leasing; money transmission; guarantees  Securities trading and issuance; asset management; advisory, intermediation and other auxiliary financial services; financial advisory	No restrictions on bank representative offices; full market access limited to acquisitions of existing licensed companies but licenses may also be granted to new entrants; foreign interests may control the entire issued share capital of banks. Foreign nationals restricted as directors of securities dealers, depending on the extent of foreign shareholding.
Vietnam	Bank guarantees  Banking and other financial services	Foreign bank branches and joint ventures may issue guarantees in limited circumstances, covering mainly overseas interests or foreign funded ventures in Vietnam.  Vietnam may limit equity participation by foreign credit institutions in incorporated Vietnamese state-owned banks; total foreign equity in joint-stock commercial banks may not exceed 30% of chartered capital; foreign bank branch is not allowed to place ATMs at locations other than its branch office

Overall, ASEAN agreements and AFTA obligations differ little from specific WTO financial sector commitments, from which some are indistinguishable, including those of Brunei, Cambodia and Indonesia,<sup>70</sup> and the marginal access to foreign interests in most cases is limited. Related issues are discussed further in section V.

### 3. APEC

Meetings of APEC finance ministers began in 1993, prior to which Japan and the United States resisted giving attention to economic matters, preferring that economic policy coordination remain the domain of the Group of Seven industrialized nations (G-7) and the Organization for Economic Cooperation and Development (OECD). APEC involvement in trade in financial services issues is circumscribed and accords with the characterization of APEC as ineffectual,<sup>71</sup> favoring hesitation against institutionalization or the use of rules. The group's diversity of interests ensures that informality is central in all proceedings. Such a governance vacuum minimizes APEC's scope to contribute to economic or financial integration and related legal

<sup>70</sup> See respectively GATS/SC/95, GATS/SC/43/Suppl.3, and WT/ACC/KHM/21/Add.2 /.

<sup>71</sup> See RAVENHILL, *supra* note 31.



reform: while APEC was thought an effective forum for economic concerns prior to the 1997-98 crisis, it has since become viewed as less successful, so that emphasis in governance and resources have shifted to ASEAN+3, the WTO and ASEAN+6.

APEC voiced support for consultations on banking and securities regulation in 1994, and in the same year issued guidelines for regional investment.<sup>72</sup> In 1996 it endorsed regulatory cooperation and prudential regulation of financial markets in accord with international standards. During the 1997-98 crisis, APEC pronounced itself in favor of stable capital flows, domestic financial market development, efforts to promote financial stability, and work to strengthen regulation of international financial intermediaries and increase cooperation among regulators to lessen global systemic risks.<sup>73</sup> No objection can be made to these pronouncements but APEC's contribution to tangible financial integration has been negligible due to its lack of institutional authority and political fragmentation.

#### **4. ASEAN-China Free Trade Agreement**

Efforts to improve the China-ASEAN free trade agreement began in 1995,<sup>74</sup> progressed in 2000 to an intention to study integration, including a formal free trade area,<sup>75</sup> and led to the creation of an expert group for ASEAN-China economic cooperation in 2001. ASEAN and China concluded a Framework Agreement on Comprehensive Economic Cooperation (ACFTA) in 2002,<sup>76</sup> and a further agreement covering the trade in goods in 2004.<sup>77</sup> These agreements

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<sup>72</sup> See Joint Statement, Sixty APEC Ministerial Meeting, 1994, available at [http://www.apec.org/apec/ministerial\\_statements/annual\\_ministerial/1994\\_6th\\_apec\\_ministerial.html](http://www.apec.org/apec/ministerial_statements/annual_ministerial/1994_6th_apec_ministerial.html) (accessed Mar. 21, 2007). APEC's Non-binding Investment Principles issued in 1994 are not only non-binding but insubstantive, available at [http://www.apec.org/apec/ministerial\\_statements/annual\\_ministerial/1994\\_6th\\_apec\\_ministerial.html](http://www.apec.org/apec/ministerial_statements/annual_ministerial/1994_6th_apec_ministerial.html) (accessed Mar. 21, 2007). On capital mobility, the document states only that "Member economies accept that regulatory and institutional barriers to the outflow of investment will be minimized" but at the same time foreign and domestic investors shall be treated alike subject to "exceptions as provided for in domestic laws, regulations and policies." *Id.* There is no more recent or specific APEC examination of cross-border investment.

<sup>73</sup> By the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

<sup>74</sup> At the first Meeting of Common Commission of Economic and Trade Cooperation between China and ASEAN.

<sup>75</sup> Proposed by China at a China-ASEAN summit meeting.

<sup>76</sup> Amended in 2003, see Protocol to Amend the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China, available at <http://www.aseansec.org/15157.htm> (accessed Mar. 21, 2007).

<sup>77</sup> Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China, available at <http://www.aseansec.org/16646.htm> (accessed Mar. 21, 2007). This includes an agreement on dispute settlement mechanisms, see <http://www.aseansec.org/16635.htm> (accessed Mar. 21, 2007).

stipulate that a free trade area will come into effect in 2010 for China and ASEAN's five founding members and expand in 2015 to include Cambodia, Laos, Myanmar and Vietnam. ACFTA has four objectives: strengthen and enhance economic, trade and investment cooperation; liberalize and promote trade in goods and services; explore new areas of cooperation; and facilitate economic integration and reduce gaps in relative development.<sup>78</sup> ACFTA covers trade in goods and services, investment and dispute resolution, but no aspect of intellectual property. The agreement commits its signatories to negotiate further liberalization of trade in services, including specific sectors and rules for foreign investment.<sup>79</sup>

ACFTA and AFTA are independent: The establishment of ACFTA represents a separate free trade agreement between China and each of ASEAN's members, and requires a dedicated administrative structure since ASEAN's resources cannot meet a greater burden. While a future ACFTA standing body could become a cooperative bridge between ASEAN and China with respect to trade, organizational aspects of ACFTA to date lag the development of trade between members, for no formal ACFTA agency exists and negotiations are handled in an ad hoc committee with support temporarily provided by ASEAN's secretariat, as it does for AFTA.

## **B. Monetary Cooperation**

Regional monetary cooperation is mainly evidenced by ASEAN+3 short-term credit lines. As noted above, an Asian Monetary Fund was mooted during the 1997-98 crisis when certain Asian states required credit to replace lost international reserves but was dismissed upon intense US opposition.<sup>80</sup> Nonetheless, the objectives of a putative regional fund were raised in ASEAN+3 in April 2006 in discussions of a possible long-term currency alliance and monetary union. The ASEAN+3 Chiang Mai Initiative (CMI) sought in 2000 to promote cooperation through the institution of bilateral currency swap agreements among central banks.<sup>81</sup> Today's network of sovereign bilateral credit lines has two roots:<sup>82</sup> collaborative foreign exchange swap lines set up

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<sup>78</sup> Framework Agreement, *supra* note 76, arts. 1 & 2.

<sup>79</sup> *Id.*, arts. 4 & 5.

<sup>80</sup> *See supra* note 46.

<sup>81</sup> *See* Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting, available at <http://www.aseansec.org/635.htm> (accessed Mar. 21, 2007).

<sup>82</sup> Counterparty risk is taken here as sovereign whether it involves a central bank or finance ministry.

by ASEAN's five original members, and a series of securities repurchase (repo) lines initiated by the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) as a precautionary reaction to the 1994 Mexican financial crisis.<sup>83</sup> These origins also reveal two aims, the first political in showing the group's robustness, and the second intended to assist economic policy.

ASEAN's arrangement began in 1977 as a modest US\$100 million set of foreign exchange swap lines, facilitating simultaneous spot sale and forward purchases of local currency for US dollars among five central banks to assist a member in temporary need of external liquidity.<sup>84</sup> The scheme was extended, expanded, and may have been utilized once each by Indonesia, Malaysia, the Philippines and Thailand between 1979 and 1981, and on a second occasion by the Philippines in 1992, in each case for modest amounts.<sup>85</sup> The arrangement's limited size and conditionality (requiring a prior IMF arrangement) prevented its use in 1997 when the members' external positions came most under pressure.

With these swap arrangements came a series of bilateral repurchase lines among EMEAP members, the first introduced in 1995-97. Japan was active in their creation, partly due to its interest in promoting regional building blocks distinct from those involving other G-7 members. The amounts involved were made public only for those involving Japan, each being of US\$1.0 billion.<sup>86</sup> The lines allowed a participant to raise major currency liquidity for intervention or other purposes by discounting with a fellow member high-grade securities held as international reserves, most commonly US government securities. Market practice knows several contexts in which the use of repurchase lines is prolific among both commercial and central banks, but EMEAP's repurchase lines are analogous to the conduct of money market operations by central banks seeking to influence domestic liquidity, including cases where a central bank accepts

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<sup>83</sup> Reported by RAMON MORENO, *Dealing with Currency Speculation in the Asian Pacific Basin*, FED. RESERVE BANK SAN FRANCISCO ECON. LETTER, 97-10 (Apr. 11, 1997). *See also infra* sec. IV.C.2.

<sup>84</sup> Such lines are a form of credit that become loans in the event of non-payment at maturity. Conforming with commercial practice, swaps might extend for up to 90 days, each once renewable with counterparty consent and the absence of a competing need.

<sup>85</sup> *See* C. RANDALL HENNING, EAST ASIAN FINANCIAL COOPERATION 14 (Institute for International Economics, 2002), citing unnamed Thai sources. A United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) report claims that the arrangement "has been extensively used" but this is unsupported and implausible, *see* SEOK-DONG WANG & LENE ANDERSEN, *Regional financial cooperation in East Asia: the Chiang Mai Initiative and Beyond*, BULLETIN ON ASIA-PACIFIC PERSPECTIVES 2002/03 90 (UNESCAP, 2003).

<sup>86</sup> *See* MORENO, *supra* note 83.

collateral in the form of prescribed securities and becomes a lender of last resort. Usage of EMEAP lines has no direct consequence for domestic credit expansion.

Excluding those involving Australia and New Zealand, two sets of lines thus evolved into more complex agreements heralded by CMI.<sup>87</sup> This spurred ASEAN members (now a group of ten) to raise their total swap arrangements to US\$1.0 billion (later US\$2.0 billion) and for China, Japan and South Korea each to pledge to maintain bilateral credit lines among themselves and with each ASEAN member, allowing currency swaps and securities repurchases.<sup>88</sup> The initiative is not an agreement but an expression of intent, making ASEAN+3 a catalyst to bilateral arrangements already customary among developed economies.

CMI's results blend purposeful display with practical confusion.<sup>89</sup> First, most of the 16 bilateral lines established by China, Japan and South Korea<sup>90</sup> entail contractual terms that make IMF sanction mandatory for most swap usage, not merely the satisfaction of conditions precedent identical to those customarily demanded by the IMF.<sup>91</sup> It would have been impossible for CMI's expanded lines to have been drawn in the Asian crisis prior to an applicant having agreed terms for IMF support, by which time any need would have become redundant. In a similar instance in mid-1997, Thailand may have used a precursor swap line with Japan.<sup>92</sup> If so, this failed to influence markets intent on selling the baht since drawing from a finite source could only encourage the seller.

Second, although the post-CMI lines provided by China, Japan and South Korea allow for

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<sup>87</sup> See *supra* note 85. The CMI is subject to no public agreement to which all its adherents are party.

<sup>88</sup> Implementation of the agreement by Cambodia, Laos, Myanmar and Vietnam has to date been waived.

<sup>89</sup> This view has support in official circles in China and Japan, for example, INSTITUTE FOR INTERNATIONAL MONETARY AFFAIRS (MINISTRY OF FINANCE OF JAPAN), REPORT SUMMARY OF STUDIES ON TOWARD [SIC.] A REGIONAL FINANCIAL ARCHITECTURE FOR EAST ASIA (2004), available at <http://www.mof.go.jp/jouhou/kokkin/ASEAN+3research.htm> (accessed Mar. 21, 2007).

<sup>90</sup> Totaling US\$75 billion equivalent as at May 4, 2006. Source: Ministry of Finance of Japan, [http://www.mof.go.jp/english/if/regional\\_financial\\_cooperation.htm](http://www.mof.go.jp/english/if/regional_financial_cooperation.htm) (accessed Mar. 21, 2007).

<sup>91</sup> In May 2005 ASEAN+3 raised the portion available unconditionally under post-CMI swap lines from 10 to 20 percent of the total "in order to better cope with sudden market irregularities" but stressed this represented no contradiction that "the international financial arrangements and other disciplined conditions would be firmly maintained." See The Joint Ministerial Statement of the 8<sup>th</sup> ASEAN+3 Finance Ministers' Meeting, May 4, 2005, available at <http://www.aseansec.org/17448.htm> (accessed Mar. 21, 2007). It is arguable that IMF compliance would be demanded for usage even had it not then made credit commitments to a hopeful user.

<sup>92</sup> *The Economist*, May 10, 2001 (cited by HENNING, *supra* note 85).

securities repurchases, this is now seen by all participants as outmoded and given little attention compared to the swap provisions.<sup>93</sup> The largest non-cash component of Asia's international reserves is held in US government securities, an archetypal broad and deep bond market. Critics suggest that the liquidity available through repurchases could not compete with so profound a source.<sup>94</sup> More attention is now paid by participants and commentators to swap operations and availability. However, this approach neglects shocks not focused on Asia, as in October 1987, when for a week following sizeable stock market losses the US treasury market was highly illiquid, frequently closed to foreign participants and employable only by negotiation among primary dealers. Infra-Asian repurchase lines could have insulatory value in such circumstances by promoting non-domestic liquidity, even if the region's reserves are concentrated in US dollar assets. Prevailing conditions have changed markedly with the substantial accumulation of reserves in ASEAN+3. That the 1995-97 repurchase lines were barely used, if at all, in the 1997 crisis was due to a scarcity of collateral or to the participants simultaneously suffering similar problems not amenable to mutual resolution.

CMI's outcome is said by ASEAN+3 to be regional but its facilities are entirely bilateral in creation and use, despite involving a gesture to harmonization and shared views of crisis avoidance. ASEAN ministers declared in 1999 that it:

shall adopt a more proactive role at various international and regional fora to ensure that its interests and priorities are given due consideration in any proposal to reform the international financial architecture.<sup>95</sup>

Market practitioners see the post-2000 CMI swap line framework as inconsequential and its significance mainly political. History suggests using swap lines other than to dampen prevailing volatility will at most delay the impact of selling pressure and may give confidence to the seller. It is ironic that CMI's cooption of IMF conditions makes credit line usage unlikely, as some participants perhaps intended, and that the older repurchase lines are neglected despite their usefulness in crises. While CMI's profile has little relation to its modest impact in form and scale, it may provide an institution to support the creation of a currency pact similar to that adopted in

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<sup>93</sup> Despite being similar to well-established financial derivative market collateralization practice.

<sup>94</sup> *E.g.*, HENNING, *supra* note 85 at 22.

<sup>95</sup> Joint Ministerial Statement of the 3<sup>rd</sup> ASEAN Finance Ministers Meeting, Mar. 20, 1999, available at <http://www.aseansec.org/742.htm> (accessed Mar. 21, 2007).

Europe in the 1970s (the so-called “snake”) or a foundation upon which to build an Asian monetary fund. By “coincidence”, these arrangements are now labeled Asian Monetary Facilities or AMF.

### **C. Capital Market Development**

Post-crisis attention to regional capital market development initially focused on the debt and money markets but has recently begun to consider wider securities market reform.<sup>96</sup> Work on debt market development has comprised three collaborative efforts: the ASEAN+3 Asian Bond Market Initiative (ABMI), APEC’s efforts in developing securitization, and work by members of the Asia Cooperation Dialogue (ACD).<sup>97</sup> It also includes EMEAP central banks’ pooling of international reserves in two Asian Bond Funds in 2004 and 2005, with a third similar fund under discussion. As in similar matters, success has been limited due to the reluctance of state actors to cede national governance to create regional policy capital. This has been most evident in the supremacy of national currency policies, to the detriment of collaborative market reform and constraining initiatives on regional trade in financial services or monetary cooperation. Little effort has been made to sanction non-bank financial intermediaries holding foreign regional assets, although they typically enjoy far greater freedom to acquire higher rated OECD investments.

#### **1. ASEAN+3, APEC and ACD**

APEC’s regional bond market initiative began in 2003, exploring regional market development and institutions to encourage financial activity.<sup>98</sup> Teams examined aspects of market development, with one seeking recommendations for securitization and credit enhancement

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<sup>96</sup> ASEAN+3 is studying cooperation among exchanges and regulators to encouraging cross-border trading.

<sup>97</sup> Thailand initiated the ACD in 2002 among ASEAN+3, India and fourteen other central Asian states to explore regional cooperation to encourage capital market activity. The group’s visibility fell after the end of Thailand’s APEC chairmanship in 2004 and may vanish entirely with Thailand’s current constitutional hiatus.

<sup>98</sup> See Joint Ministerial Statement, Tenth APEC Finance Ministers’ Meeting, Sep. 5, 2003, available at [http://www.apec.org/apec/ministerial\\_statements/sectoral\\_ministerial/finance/2003\\_finance.html](http://www.apec.org/apec/ministerial_statements/sectoral_ministerial/finance/2003_finance.html) (accessed Mar. 21, 2007).

mechanisms to improve the credit risk quality of Asian bonds.<sup>99</sup> APEC asked if securitization could provide a continuous fundraising mechanism in the region and assist in the recycling of non-performing financial assets. The work was led by officials from Hong Kong, South Korea and Thailand, the first two having experience of legislation to promote structured finance.

Soon afterward, ASEAN+3 commissioned similar research as part of the ABMI, with working groups given support from ADB resources. They investigated using securitization to increase the supply of debt instruments, enhancing credit risk by providing institutional credit enhancement, improving clearing, custody and settlement systems, developing new credit rating agencies and encouraging information flows, harmonizing market regulations to best practices, and removing legal and regulatory impediments to cross-border bond investment. The final group's work ended prematurely, in an example of conflict between national and regional interests. It was charged to explore cross-border local currency bond issuance by multilateral agencies, governments and their agencies, and regional companies, the group's convener allowed it to examine issuance only by multilateral agencies.<sup>100</sup> After inaugural new issues in China and Thailand by the ADB and the World Bank's International Finance Corporation (IFC), the group declared its mission ended and it dissolved in 2004, leaving many omissions from its original agenda.<sup>101</sup> In their contribution to governance, ASEAN's projects generally constitute functional specificity that is "so trivial as to remain outside the stream of human expectations and actions vital for integration."<sup>102</sup>

## **2. Pooled Reserves: Asian Bond Funds**

EMEAP's central banks are those from ASEAN's founding five members, plus Australia, China, Hong Kong, Japan, South Korea and New Zealand. Its non-Japan Asian members are the nominal sponsors of collaborative ideas developed by Hong Kong and Thai officials and

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<sup>99</sup> Securitization is a tool of structured finance involving the sale of loans or other financial assets, funded by the simultaneous sale to third party investors of new securities issued by the asset buyer, which is an insubstantive company or trust. See DOUGLAS ARNER, *Emerging Market Economies and Government Promotion of Securitization*, 12 DUKE J. COMP. & INT. L. 505 (2002)

<sup>100</sup> The group was led by officials of China.

<sup>101</sup> Many remaining impediments are listed in ARNER, LEJOT & RHEE, IMPEDIMENTS TO CROSS-BORDER INVESTMENTS IN ASIAN BONDS, *see supra* note 53.

<sup>102</sup> HAAS, *supra* note 37, at 372.

implemented as the two Asian Bond Funds (ABF1 and ABF2), which are poolings of a fraction of international reserves. The plan had two roots: criticism of Asia massing reserves in non-Asian assets, and the proposition that active capital markets could provide a stabilizing resource in times of heightened volatility. The project had initial assistance from the Bank for International Settlements (BIS), which was politically important given an absence of usable regional or shared institutions, and avoided creating a hierarchy among the participants or the unnecessary creation of a supervening regional steering organization. Ironically, the principal fund managers for the project are of British or American domicile.

Both funds are indexed and involve no discretionary management. Their aggregate at inception was equivalent to less than 0.15 percent of the subscribers' aggregate reserves but the project is innovatory in several respects. While the funds cannot directly contribute to liquidity they depart from traditional reserve management practice by including sub-investment grade EMEAP sovereign risks. ABF1 is a US\$1.0 billion pooling of core currency Asian bonds held by EMEAP's Asian members.<sup>103</sup> The later ABF2 is a US\$2.0 billion fund for local currency issues, with families of single currency exchange-traded funds and regional index funds each acquiring and holding sovereign and quasi-sovereign Asian securities. Hitherto, proposals to create regional bodies have been ambitious and not easily implemented,<sup>104</sup> so if the more complex ABF2 is successful it may lead to structural regional cooperation. It has prompted the creation of Asia's first exchange-traded bond fund, led two jurisdictions to permit domestic currency exchange-traded funds, and its regional index fund was the first non-bank intermediary to be granted access to China's domestic interbank bond market.<sup>105</sup>

ABF2's single currency and regional index funds provide a means to lessen problems associated with direct investment in local currency instruments by most offshore investors and certain domestic investors, including those affecting custody, enforcement of rights, reliability of transfer, and taxation.<sup>106</sup> If the plan succeeds, it will do so not overtly but by encouraging the

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<sup>103</sup> Many OECD central banks trade actively in liquid foreign currency debt securities but the assets held by ABF1 are generally illiquid and represent the fund's feasible investment universe.

<sup>104</sup> For example, currency cooperation pacts discussed at intervals by APEC and ASEAN.

<sup>105</sup> EMEAP Press Statement, "The Asian Bond Fund 2 has moved into Implementation Phase", May 12, 2005 available at <http://www.emeap.org/> (accessed Mar. 21, 2007).

<sup>106</sup> See ARNER, LEJOT & RHEE, *supra* note 53.



removal of legal and regulatory constraints that currently make its objectives impossible to achieve. The test of the project must be whether it generates liquidity and induces new participants to issue, invest or trade. Yet in its first six months the sums raised from non-EMEAP sources amounted to only US\$200 million, and it has not since succeeded in attracting material outside interest.<sup>107</sup> This project is demanding because it seeks to circumvent pervasive problems of investor access, custody, enforcement, transfer and taxation that exist for non-bank investors throughout the region, but in so doing will be self-limiting as to its external impact on market development. Indeed, pre-establishment announcements in 2004 suggested this might be intentional in that ABF2 would “accelerate market and regulatory reform.”<sup>108</sup> Unsurprisingly, no such commitments have been disclosed.

### **3. Equity Market Development and Cooperation**

Integration of Asia’s equity markets is almost non-existent but opportunities for regional collaboration may arise from the adoption of common minimum standards by domestic securities regulators, probably enhancing certain standards from the International Organization of Securities Commissions (IOSCO). IOSCO is an organization of wide membership that coordinates and leads cooperation, benchmarking and information exchange among securities regulators.<sup>109</sup> Its memorandum of understanding covering interaction among regulators is a template for cooperation, information exchange and enforcement, and four documents first developed in 1998 now provide a comprehensive body of principles and standards for securities regulation,<sup>110</sup> including an internationally acceptable offering document that incorporates International Financial Reporting Standards (IFRS) and provides the basis for the format and

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<sup>107</sup> “Pan Asia fund fails to excite investors,” Fin’l Times, Jun. 13, 2006.

<sup>108</sup> EMEAP Press Statement, “EMEAP Central Banks Announce the Launch of the Asian Bond Fund 2,” Dec. 16, 2004, available at <http://www.emeap.org/> (accessed Mar. 21, 2007).

<sup>109</sup> IOSCO has the widest national membership and affiliations of any transnational financial industry body, see <http://www.iosco.org/lists/index.cfm?section=general> (accessed Mar. 21, 2007). All jurisdictions considered in this article are full IOSCO members. IOSCO seeks to promote cooperation among regulators for the benefit of market openness, effectiveness and integrity of use. See <http://www.iosco.org/about/> (accessed Mar. 21, 2007).

<sup>110</sup> Covering the objectives and principles of securities regulation; international disclosure standards for cross-border offerings and foreign listings; risk management and control guidance for securities firms; and methodologies for determining minimum capital standards for internationally active securities firms. This mission was set largely at the behest of the Group of Seven industrialized countries (G-7).

content of cross-border offering documents.<sup>111</sup> This may in due course influence equity offerings in Asia and elsewhere, and is seen at its most ambitious in the 2003 EU prospectus directive.<sup>112</sup> To date, Asian securities regulators have formed an Asia-Pacific regional committee under the IOSCO umbrella, and are engaging in limited discussions (with support from the ADB) on possible use of IOSCO standards as a basis for cooperation.

#### **D. The Role of the ADB?**

The ADB mixes regional interests and elements of regional governance. While its operations focus on regional development, 18 of the bank's 65 shareholders are non-Asian OECD members that together account for 34.75 percent of votes in the bank's supervisory board of governors. Members of the G-7 group hold 39.9 percent of votes in the board of governors, the latter electing a 12 person board of directors, four of whom represent non-Asian members. China, Japan and the United States each nominate a director to serve their sole interests. As with other Asian organizations, the regional interests of ADB policy may not coincide with the aims of all shareholders. Asian policymakers have been supportive of ADB efforts because of the weak institutional basis of other bodies, including ASEAN and APEC.

At the same time, the ADB has given material support to financial sector cooperation, and policymakers may welcome its efforts because of a lack of resources and institutional weaknesses in ASEAN and APEC. For example, it became involved in a coordinating function with the CMI in 2005, and established six groups in 2002 to support market development with funding and technical assistance at the same time as the launch of the ABMI by ASEAN+3.<sup>113</sup> The Bank also views its own local currency funding transactions as developmental, although they rely more on the structuring resources of private law than reforms in national policy, and hopes to widen the availability of market information through a web portal more comprehensive

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<sup>111</sup> See DOUGLAS ARNER, *Globalization of Financial Markets: An International Passport for Securities Offerings?*, 35 INT'L LAW. 1543 (2002).

<sup>112</sup> EU directive on the prospectus to be published when securities are offered to the public or admitted to trading, 2003/71/EC, Nov. 4, 2003.

<sup>113</sup> Khempheng Pholsena, ADB Vice President (Finance and Administration), "Opening Remarks at the Asian Bond Markets Initiatives," Seminar on Local Currency Bond Issuance by Foreign Multinational Corporations, Shanghai, Aug. 5, 2004, available at <http://www.asiandevbank.org/Documents/Speeches/2004/ms2004049.asp> (accessed Mar. 21, 2007).

than many commercial or national sources.<sup>114</sup>

More significantly, a new Office of Regional Economic Integration (OREI) seeks to promote economic cooperation and integration among the bank's developing members and contribute to the region's "harmonious economic growth."<sup>115</sup> This is part of the agenda of the current ADB president, placing emphasis on regional integration, financial integration, and providing resources and funding for research and related technical assistance projects and investments. A successful OREI may ameliorate the ADB's generally agreed lack of coherent objectives compared to the World Bank, which has a focus on domestic markets and engaging with the commercial sector. A 2007 study by an ADB Eminent Persons Group found agreement with these reforms.<sup>116</sup>

## **V. Influences from Non-Asian Financial Integration**

This section V discusses three external influences relevant to Asian financial regionalism and governance: international trade in financial services negotiations; international financial standards; and European regional financial integration.

### **A. International Framework for Financial Services**

The framework for foreign participation in national financial services is subject to bilateral, regional and international negotiations, with the latter concentrated in the WTO process through the GATS.<sup>117</sup> The GATS contains general obligations respecting trade in services, including

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<sup>114</sup> See <http://asianbondsonline.adb.org> (accessed Mar 21, 2007).

<sup>115</sup> Haruhiko Kuroda, ADB President, Opening Remarks, Governors' Seminar on a Roadmap for Asia's Economic Cooperation and Integration, ADB 2005 Annual Meeting, Istanbul, May 3, 2005, available at <http://www.adb.org/AnnualMeeting/2005/Speeches/president-kuroda-speech-roadmap.html> (accessed Mar. 21, 2007). OREI was created in April 2005.

<sup>116</sup> Report of the Eminent Persons Group to the President of the Asian Development Bank, *Towards a New Asian Development Bank in a New Asia* (Mar. 2007). The group comprised Supachai Panitchpakdi, Isher Judge Ahluwala, Nobuyuki Idei, Caio Koch-Weser, Justin Yifu Lin and Lawrence Summers.

<sup>117</sup> As a result of the Uruguay round of negotiations, the GATS has four parts: its central agreement, eight annexes, schedules of commitments, and exemptions to Art. II on most favored nation treatment (MFN). The "GATS text" refers to the first part of the four.

most favored nation (MFN) treatment,<sup>118</sup> transparency,<sup>119</sup> and domestic regulation.<sup>120</sup> As one aspect of its general coverage of services, the GATS addresses financial services.<sup>121</sup> It also includes further elective provisions for financial services liberalization that set generally higher requirements for members.<sup>122</sup> All these commitments form the setting and basis for negotiations addressing liberalization of trade in financial services, but since the provisions for foreign access are not inclusive, as with trade in goods, their adoption remains in the discretion of WTO members and financial services trade liberalization is thus often limited.

Participation in the WTO process will influence future financial services liberalization in Asia but it is unclear at present their relation to regional cooperation. At the same time, such influences may be diluted by an ongoing preference for bilateral agreements.

In respect to interaction with regional frameworks such as the ASEAN AFAS, the GATS does not prevent its members from becoming party to agreements to liberalizing the trade in services,<sup>123</sup> and although it contains restrictions on regional economic integration, the WTO process is permissive with regard to regional trade agreements. Since WTO financial commitments overlap with many regional trade agreements, both are relevant to any program for financial liberalization. Overall, at present, ASEAN agreements and AFTA obligations differ little from specific WTO financial sector commitments, from which some are indistinguishable, including those of Brunei, Cambodia and Indonesia.<sup>124</sup> For example, Indonesia repeated certain WTO commitments in its ASEAN/AFTA Schedule;<sup>125</sup> Cambodia's ASEAN/AFTA and WTO financial sector commitments are generally identical;<sup>126</sup> and Brunei's ASEAN/AFTA and WTO

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<sup>118</sup> GATS, Art. II has three paragraphs applicable to all services sectors. The first is a rule identifying MFN obligations in the trade in services, requiring member states to treat the services and suppliers of other members no less favorably than accorded to like services and service suppliers of other countries.

<sup>119</sup> The obligation of transparency provided by GATS, Art. III has three categories, an obligation to publish relevant measures or international agreements affecting the trade in services, an obligation of notification to the WTO's Council for Trade in Services of new laws or changes to existing law that significantly affect that trade, and an obligation of formal responsiveness to requests for information by other WTO members.

<sup>120</sup> GATS, Art. VI.

<sup>121</sup> GATS, Art. I: 3(b) excludes services supplied in the exercise of governmental authority.

<sup>122</sup> The GATS Understanding on Commitments in Financial Services.

<sup>123</sup> GATS, Art. V:1.

<sup>124</sup> See respectively GATS/SC/95, GATS/SC/43/Suppl.3 & WT/ACC/KHM/21/Add.2 /.

<sup>125</sup> That access limits in the non-bank sub-sector will be eliminated by 2020 subject to similar commitments by other states, see GATS/SC/43/Suppl.3.

<sup>126</sup> On market access limitations, see WT/ACC/KHM/21/Add.2.

commitments are almost identical.<sup>127</sup>

In contrast, China's WTO accession commitments to liberalize banking and insurance are more extensive than those of other most other developing economies,<sup>128</sup> and it can be argued that China's influence on ASEAN+3 may lead to broader financial services liberalization among ASEAN+3 members currently maintaining more restrictive GATS commitments. In addition to China, Cambodia's WTO commitments are probably the most liberal in the region, followed by Hong Kong, Singapore, Vietnam and China. However, these commitments (to the extent applicable: China and Hong Kong are not ASEAN members) have not been actually replicated in the AFAS framework.

The framework is a sound beginning to supporting foreign competition in financial services trade, but needs to be extended through negotiation and incorporated into international standards. This is important in the relationship between liberalization and financial stability. Acceding WTO members commit to certain levels of financial services liberalization in banking, securities markets and insurance, but taking such measures without regard for sequencing and safeguards can be a precursor to excessive volatility, and was a consideration in the Asian financial crisis. Analysis of recent crises also indicates the essential function of institutions, including the role of law, enforcement, regulation and legal systems in lessening or making manageable the risks associated with financial liberalization.<sup>129</sup> Linkages in prudential regulation and financial liberalization are increasingly accepted and have been recognized as important in EU regional financial integration.

## **B. International Financial Standards**

One response to financial crises in the 1990s was a series of standards and codes to deal with institutional weaknesses and contagion. Above all, the 1994-95 Mexican financial crisis caused

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<sup>127</sup> They differ only in respect of the sub-sector, advisory and other auxiliary financial services, *see* ASEAN/AFTAGATS/SC/95.

<sup>128</sup> *See* JAMES BARTH, ZHONGFEI ZHOU, DOUGLAS ARNER, BERRY HSU & WEI WANG (eds.), *FINANCIAL RESTRUCTURING AND REFORM IN POST-WTO CHINA* (Kluwer, 2006). Domestic motives may have helped prompt the scale of China's undertakings.

<sup>129</sup> *See* ARNER, ch. 8, *supra* note 1.

leading industrial nations to seek mechanisms to protect against systemic financial instability induced by shocks of all kinds.<sup>130</sup> In 1996, the Group of Ten (G-10) states examined with emerging and transition economies how best to foster financial stability,<sup>131</sup> finding that robust systems are less susceptible to crisis and more resilient if such crises materialize.<sup>132</sup> The study cited three essential elements in robust financial systems: the creation of institutions and infrastructure necessary for a sound credit culture and effective markets; promoting the functioning of markets so that commercial actors exercise adequate discipline over financial intermediaries; and creating regulatory and compliance arrangements to complement market discipline.<sup>133</sup> The IMF, World Bank and regional development banks were entrusted to lead in providing technical assistance to strengthen national financial systems, and are meant to cooperate in so doing so as to avoid overlapping or disjunctive efforts.

The system of international standards to encourage emerging market stability has four characteristics:<sup>134</sup> First, an international consensus has developed regarding elements necessary to sound financial and regulatory systems.<sup>135</sup> Second, international and national authorities collaborate in specific fields to formulate sound principles and practices through certain fora, including the Basel Committee on Banking Supervision, International Accounting Standards Board (IASB) and IOSCO. Third, jurisdictions (both national and regional) implement standards directly into their respective legal and regulatory frameworks. Fourth, multilateral institutions promote sound principles and practices. The burden of strengthening financial systems lies with national governments and their agencies, but both the WTO financial framework and evolving

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<sup>130</sup> See DOUGLAS ARNER, *The Mexican Peso Crisis of 1994-95: Implications for the Regulation of Financial Markets*, 2 L. & BUS. REV. AMERICAS 28 (1996).

<sup>131</sup> Report of the Group of Ten Working Party on Financial Stability in Emerging Markets, *Financial Stability in Emerging Market Economies: a Strategy for the Formulation, Adoption and Implementation of Sound Principles and Practices to Strengthen Financial Systems* (“G-10 Strategy 1997”), G-10, Apr. 1997. The framework was developed further among the Group of 22 Systemically Significant Countries (G-22), *Reports on the International Financial Architecture*, Oct. 1998. All G-10 publications are available at <http://www.bis.org>.

<sup>132</sup> Crises are taken to have a potentially deleterious effect on social and economic instability, growth and lead to less efficient allocations of savings and investment. *Id.* at 1.

<sup>133</sup> *Id.* at 3-4.

<sup>134</sup> See ARNER, ch. 3, *supra* note 1.

<sup>135</sup> This is not to emphasize concerns that may be ephemeral, for example, regulators are now absorbed by the results of credit risk being dispersed among non-bank intermediaries subject to light supervision of capital or liquidity. Former UK regulatory head Howard Davies stated at the 2007 Davos World Economic Forum:

We all know that the reality of the financial markets is that risk is being parcelled up and paced around. But international regulatory architecture is still organised as if the world had not changed.

As a result, we have a regulatory architecture designed for a bygone age.

See Gillian Tett, “Derivatives bring drama to Davos,” *Fin'l Times*, Feb. 1, 2007.

international financial standards are compatible with and potentially reinforcing of regional financial integration, as has been most soundly demonstrated by experiences in Europe.

### C. Europe's Experience with Financial Integration

It has long been controversial to draw generic lessons from EU experience as to conditions or prospects for regionalism<sup>136</sup> but the approach taken elsewhere to specific technical aspects of financial integration may be helpful in discussing the obstacles that Asia confronts. In analyzing European experience, a number of stages can be identified. At the first stage, European officials recognized the potential benefits of and barriers to European financial integration. An influential 1966 study was first to address impediments to the functioning of Europe's national markets and their openness to foreign borrowers,<sup>137</sup> identifying a home bias towards national governments and other domestic borrowers achieved through regulations on permissible investment by banks and insurers. Further, few companies were listed outside their domiciles. These conditions generally reflect how Asia's markets function some 40 years later, albeit with greater transactional sophistication.

Financial integration among EU states is the most developed of any region, the result of objectives set over a long period since the 1950s, in particular to the creation of a single internal market in financial services. Advances in integration have transformed major markets among professional intermediaries but Europe's trade in retail financial services remains fragmented and not yet subject to regional competition.<sup>138</sup> This is the result of strong national socio-economic

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<sup>136</sup> ERNST HAAS, *Turbulent Fields and the Theory of Regional Integration*, 30 INT. ORG. 2, 173 (1976).

<sup>137</sup> See SEGRÉ ET AL, *supra* note 14.

<sup>138</sup> The EU's official view in 2005 was that:

A long-anticipated surge in EU cross-border banking integration and consolidation has failed to materialize. This failure is striking in view of several apparently catalytic developments — notably the liberalization of capital movements and efforts to create an internal market in financial services [...] However, cross-border integration have [sic.] not been major features of developments in EU retail banking in recent years and this latest disappointment suggests that obstacles — other than exchange-rate risk — have yet to be addressed.

See *The EU Economy: 2005 Review* (European Union, 2003) available at [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/the\\_eu\\_economy\\_review2005\\_en.htm](http://ec.europa.eu/economy_finance/publications/european_economy/the_eu_economy_review2005_en.htm) (accessed Jan. 31, 2007). One leading banker argues that:

a unified European financial market is still far from reality. One reason is that even where the [Financial Services Action Plan] has created a common legal basis, there are differences in actual implementation of the rules by the member states. [...] Another reason is that in some segments,

norms that reform and regulation find difficult to overturn, although the introduction of the euro may have induced greater similarities in national retail financial markets.<sup>139</sup>

EU founding treaties provide for free movement of goods, services, workers and capital, and freedom of establishment. In theory, investments may be made without restriction across national borders. However, these initial ideals did not begin to have real meaning until the mid-1980s, the second stage of EU financial integration focusing on harmonization to minimum standards. Today's level of integration has been achieved in these dimensions partly due to supportive rulings of the European Court of Justice (ECJ), and markets have become considerably harmonized,<sup>140</sup> so that national legislation over most market segments now reflects regionally initiated developments. Member states must adhere to certain precepts so that decisions and legislation passed at EU level will directly affect those in individual states, while national governments may be liable in damages for failing to implement EU legislation to the detriment of their citizens. No similar obligations exist elsewhere in a regional setting. In a more technical sense EU experience shows how collaboration and political integration may encourage the adoption of sound principles and practices. The concept of mutual recognition and a system providing a single regulatory license for financial intermediaries now allow EU directives to set minimum norms without hindering competition.

The EU legislative framework for financial markets seeks equivalence among disparate regulatory and legal systems, so that regional initiatives recognize national legal and regulatory

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Europe still lacks the necessary legal and institutional framework for truly integrated markets. [...] Even worse is the situation in retail markets.

See Josef Ackermann, Chairman, Deutsche Bank, "Europe has to storm cross-border financial barriers", *Fin'l Times*, Jan. 25, 2007. Furthermore,

removing the remaining barriers to market integration will require what trade experts call "deep integration", that is, addressing issues such as consumer protection regimes and mortgage collateral laws that have so far been the prerogative of individual member states.

*Id.* This characterization applies to many Asian market sectors. Impediments to European financial services harmonization are discussed in APOSTOLOS GKOUTZINIS, *INTERNET BANKING AND THE LAW IN EUROPE: REGULATION, FINANCIAL INTEGRATION AND ELECTRONIC COMMERCE* (Cambridge University Press, 2006) at 51-63.

<sup>139</sup> See CHRISTOFFER KOK SØRENSEN & JOSEP MARIA PUIGVERT GUTIÉRREZ, *EURO AREA BANKING SECTOR INTEGRATION: USING HIERARCHICAL CLUSTER ANALYSIS TECHNIQUES 7-8* (European Central Bank Working Paper No. 627, 2006), available at <http://www.ecb.int/pub/pdf/scpwps/ecbwp627.pdf>, accessed Mar. 21, 2007.

<sup>140</sup> ELEMÉR TERTAK, Director, European Commission Financial Institutions Directorate, speech at the Conference of the Euro: Lessons for European and Asian Financial Markets, Hong Kong, Feb. 24, 2006.



regimes.<sup>141</sup> Rule harmonization proved impossible for many activities and the European Commission adopted principles first outlined in a 1985 white paper (the basis of the second stage of development),<sup>142</sup> that led to the Single European Act.<sup>143</sup> This stipulated a common internal market based upon mutual recognition and common minimum standards, made applicable by EU directives and brought into effect through domestic law.<sup>144</sup> Member states would recognize each other's law, regulations and authorities structured along common minimum standards, enabling the freeing of the trade in goods and services without need for prior harmonization.<sup>145</sup> The system also uses minimum regional requirements to limit competitive deregulation by state actors and regulatory arbitrage by commercial parties.

National financial regulation in Europe has intensified in recent years due to a combination of the needs of government and pressure from harmonization, access deregulation, and prudential re-regulation inherent in the process of market opening developed under the Maastricht Treaty for unhindered capital mobility. The EU framework for financial services provides minimum standards for financial intermediaries, securities regulation, accounting, company law, and regulation of institutional investors, based on intermediation being unfettered by national borders or restrictions on activity, and an open internal market. However, harmonization leaves the framework incomplete since it augments rather than replaces existing national laws.

Today's single market is manifested in "passport directives,"<sup>146</sup> by which an authorized intermediary may generally be able to supply services overseas directly or through a foreign branch without maintaining a permanent presence in its target market.<sup>147</sup> The passport's aim is to promote competition and allow intermediaries to choose how they deliver products or services into any part of the internal market.<sup>148</sup> Passport directives in financial services define the

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<sup>141</sup> See BENN STEIL, *THE EUROPEAN EQUITY MARKETS: THE STATE OF THE UNION AND AN AGENDA FOR THE MILLENNIUM* 113 (Brookings Institution, 1996).

<sup>142</sup> EUROPEAN COMMISSION, *COMPLETING THE INTERNAL MARKET: WHITE PAPER FROM THE EUROPEAN COMMISSION TO THE EUROPEAN COUNCIL*, Com(85)310 final (1985).

<sup>143</sup> Single European Act, 1987 OJ (L 169) 1 (1987).

<sup>144</sup> *Id.*

<sup>145</sup> See STEIL, *supra* note 140.

<sup>146</sup> Passport directives in financial services address banking, investment services, collective investment schemes, life and non-life insurance, and pension funds.

<sup>147</sup> See I. FRASER & P. MORTIMER-LEE, *The EC Single Market in Financial Services*, 33 *BANK OF ENG. Q. BULL.* 1, 92 (1993).

<sup>148</sup> *Id.*

intermediary to which they apply, its activities or market segment, the conditions for initial and continuing authorizations, the division of regulatory responsibility between the home (domicile) state and the host (target) state,<sup>149</sup> and aspects of dealings with non-EU member states.<sup>150</sup> Such free movement of capital to facilitate European monetary union became effective through the Maastricht Treaty in 1994. This provided an impetus for states to implement prior financial services directives and led to members other than Ireland and the United Kingdom adopting legislation that was foreign to their traditional market practices. The introduction of the euro in 1999 had a further catalytic effect on the nature of market flows and activity. Following the introduction of the single currency, EU members were forced to turn once again to increasing levels of regulatory convergence, a process which is ongoing and represents the third stage of development.

Prior to this degree of political consent, commercial interests may have been a force for financial integration, if only among professional intermediaries. Until the 1990s introduced a high common level of regulatory intensity, the Eurobond markets and eurocurrency interbank markets were permissive institutions that arose as a result of national legal and regulatory impediments to capital flows of all kinds.<sup>151</sup> Eventually their scale began to rival national markets in banking and securities, leading to protracted negotiations in the early 1990s between industry representatives and regulators that resulted in offshore activity infiltrating national markets and subsuming many disparate local practices. The process became entrenched with the introduction of the euro. There is little near-term chance of Asia following this precedent, regardless of whether the offshore European markets of the 1970s and 1980s were part of a trend towards financial integration or relied upon institutional barriers to be effective. One contemporary source saw the Eurobond market as a substitute for financial integration, given that capital mobility was only a secondary EU goal until the 1990s.<sup>152</sup> Others referred to the Eurobond market relying on an “asymmetry” between local and foreign targeted national capital

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<sup>149</sup> The home state will generally be responsible for the supervision of intermediaries, their branches and the fitness and propriety of managers and major shareholders. The host state will be responsible for conduct within its jurisdiction. *Id.* at 93.

<sup>150</sup> *Id.*

<sup>151</sup> See also *supra* sec. II & note 11.

<sup>152</sup> KURT RICHBACHER, *The Problems and Prospects of Integrating European Capital Markets*, 1 (3) J. MONEY, CREDIT, BANKING 337 (1969).

controls.<sup>153</sup> Similarly, the 1966 Segré report was prescient of the potential for financial integration or how officially inspired integration might be confounded by commercial interests. If a capital market can be established anywhere, then what need is there for formal integration unless and until monetary integration is also an objective?<sup>154</sup>

## **VI. Conclusion: Governance and Financial Integration**

Europe's protracted experience in forming a single regional financial market indicates the scale of obstacles to Asian financial integration, which at best is only at a level equivalent to the first stage of European efforts. Policy attention given since the mid-1990s to Asian market development has led to two tangible results. The first, a repurchase line construct (the CMI), may be discounted; the second, two ABFs, is constrained from directly affecting liquidity or supporting development at any meaningful level. Yet that these steps have been taken nonetheless suggests that practical objectives could be employed to guide all national and regional reforms. If regionalism is taken to be the results of a large scale conception, for example:

From a "global" perspective, regionalism constitutes a transnationalization of economic and political activity, which implies the transcendence of state boundaries in the interests of ensuring cooperation and reducing the potential for conflict.<sup>155</sup>

Or alternatively:

From a "bottom-up" perspective, the formation of a regional bloc is concerned with various dimensions of state-building. The rationale for regionalism is invariably that there are common goals which can best be pursued in concert with other states or actors.<sup>156</sup>

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<sup>153</sup> See ROBERT GENILLARD, *The Eurobond Market*, FINANCIAL ANALYSTS JOURNAL 151 (March-April 1967). The article concluded that the Eurobond market was a "fine example of the benefits of international collaboration by bankers in a fully competitive climate."

<sup>154</sup> See SEGRÉ ET AL, *supra* note 14. Segré argued for harmonization of non-retail national markets in ways later encouraged by the Eurobond market. *Id.* at 195 & 202.

<sup>155</sup> NICOLA PHILIPS, *Governance after Financial Crisis: South American Perspectives on the Reformulation of Regionalism*, 5 (3) NEW POLIT. ECONOMY 386 (2000).

<sup>156</sup> *Id.*

Even if the transnational model of regionalism has no application in Asia due to entrenched national interests, the more practical functionalism implicit in the second alternative is a limited objective in financial integration to which ASEAN+3 members may become willing to accept.<sup>157</sup>

This in turn suggests that Asia can gain insight from EU experience in certain technical respects:

the principle of minimum harmonization together with mutual recognition principles underlines the potential for leaving integration to market forces once national legal and regulatory frameworks share common minimum standards.<sup>158</sup>

As such, elements of the second stage of European financial regionalization may eventually assist the process of Asian financial cooperation and development, notably in mutual recognition, harmonization to common minimum standards and shared commitments to reform. Initiatives adopted within ASEAN+3 and EMEAP may increase accountability, transparency and the extent of participation in reform by commercial actors in ways that become generally beneficial to economic development. This is conceptually similar to ASEAN's existing approach and accords with the ADB identifying accountability, predictability, participation and transparency as principles of essential financial governance.<sup>159</sup>

Cooperation in financial policy among Asia's economies has a short history and slender results, even though Asia's need for market reforms is associated with substantial tasks in national and multilateral policymaking, and might have been profoundly accelerated by the 1997-98 crisis. Past regional initiatives on financial issues have lacked practicality, or foundered when confronted by competing national interests, especially from China, Japan and the United States,<sup>160</sup> leading to doubts as to the effective influence in financial policy formation of Asia's

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<sup>157</sup> See AMITAV ACHARYA, *How Ideas Spread: Whose Norms Matter? Norm Localization and Institutional Change in Asian Regionalism*, 58 INT. ORG. 239-275 (Spring, 2004) (using a similar argument in the context of cooperative regional security).

<sup>158</sup> CALLY JORDAN & GIOVANNI MAJNONI, FINANCIAL REGULATORY HARMONIZATION AND THE GLOBALIZATION OF FINANCE 9 (World Bank Policy Research Working Paper No. 2919, 2002). Furthermore,

in a financially integrated world, size matters both for regulated entities and for the regulators and the same set of rules may not be efficient and equitable for both large and small players.

*Id.* at 9-10.

<sup>159</sup> ASIAN DEVELOPMENT BANK, IMPROVING GOVERNANCE AND FIGHTING CORRUPTION: IMPLEMENTING THE GOVERNANCE AND ANTICORRUPTION POLICIES OF THE ASIAN DEVELOPMENT BANK, 2006.

<sup>160</sup> See e.g., JAMES BAKER, THE POLITICS OF DIPLOMACY: REVOLUTION, WAR, AND PEACE, 1989-1992, 609-11 (G.P. Putnam's Sons, 1995). The former US Secretary of State notes his determination while in office that "any move towards economic integration in East Asia include the United States," such that notably in 1991 he did his "best to

multiplicity of regional bodies.<sup>161</sup> To the extent that material results now exist, their value may rest in the fact of completion. At the same time, there have been long-standing examples of the adoption by national authorities of like external financial policies, most clearly seen in currency management in the five years prior to 1997.

Asia's economic and financial integration lacks an institutional and legal framework set within the region. In contrast to the rule-focused WTO or European Union, the region's economic organizations and institutions are oriented towards bilateral dealings among participating states and are deliberately intended to have minimal impact on national sovereignty. More generally, greater financial integration requires a new approach to governance, in which three aspects of policy would be prominent.

First, states would recognize shared interests in protecting regional competitiveness. This might imply the acceptance in due course of certain political consequences, for example in considering whether external mercantilism need be paramount in national economic policy. Such issues become paramount in the context of exchange rate arrangements, suggesting that such aspects will likely remain problematic but perhaps permitting an increasing cooperative approach to reserves and regional investment. At the same time, in the state-led arena, efforts to bring regional financial services trade commitments in line with international negotiations offer the possibly the most promising route, especially if China begins to hold others to similar liberalization commitments to those which it has made in the context of WTO accession.

Second, the commercial sector has been included in Asian financial integration only as a residual matter and, in contrast with the EU pattern, given no transparent role in governance other than any resulting from global initiatives. Financial integration may require "multi-level governance"

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kill" an East Asian Economic Group then proposed among APEC's East Asian members.

<sup>161</sup> Sceptics include NICK BISLEY, *The End of East Asian Regionalism?*, 17 (1) J. EAST ASIAN AFF. (2003); JOHN RAVENHILL, *APEC Adrift: Implications for Economic Regionalism in Asia and the Pacific*, 13 PAC. REV. 2 (2000). Others see policy success in the creation of bilateral central bank repurchase and credit lines, especially their expansion under the CMI. NICHOLAS THOMAS, *An East Asian economic community: multilateralism beyond APEC*, Conference: Asia-Pacific Economies: Multilateral vs. Bilateral Relationships, City University of Hong Kong, May 2004; SUSUMU YAMAGAKE, *The Construction of an East Asian Order and the Limitations of the ASEAN Model*, 12 ASIA-PAC. REV. 2 (2005) suggesting that Asia's regional model body may inherently conflict with collective policy initiatives.

that involves many actors, rather than Asia's state-centric tradition.<sup>162</sup> In fact, it is actually the case that sub-national actors such as central banks and financial regulatory agencies have locus of the most developed initiatives to date. In all likelihood, and reflecting experiences with international financial standards and technocratic cooperation, regional efforts toward regulatory cooperation and harmonization to common regional standards based upon international standards and perhaps influenced by EU legal instruments are amongst the most promising roads towards greater integration, financial stability and development.

Finally, since Asia's prevailing regional organizations and institutions are weak or constrained by state-orientated governance, the outcome for future financial integration and development is a function of the nature of the actors involved in their instigation, whether they represent national, commercial or other interests.

In effect, such adjustments would augment mechanisms for convergence in financial activity and regulation. During the 1997-98 crisis, national authorities failed to find collaborative or regional solutions to regional problems of contagion. Ten years later, the situation in all likelihood would be no more accommodating in a future shock, unless China for reasons of extending its own influence determined to provide support. Without devoting resources in governance to improve regional financial integration and support domestic legal and regulatory reform, Asian economies will continue to rely heavily on risk averse portfolio management, in particular by holding high foreign currency reserves, to the detriment of their own financial development and stability.

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<sup>162</sup> See Payne, *supra* note 26 at 211-212.