

ASEM Conference:  
Beyond the Global Crisis: A New Asian Growth Model?

**Financial Liberalization, Integration and Regulation in Asia**

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**I. Introduction**

Financial integration is less pronounced in East Asia than among states in Europe and North America or compared to economic integration within the region. 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 generally lightly institutionalized. The interplay between national and international finance is limited, even among nations with relatively sophisticated financial systems such as Singapore or South Korea. No existing market can be considered regional: Asian intermediaries freely enter global capital market transactions denominated in non-regional currencies but regional markets remain underdeveloped and price opaque. This dichotomy persists despite certain developments since the early 1990s that created incentives for financial integration and notwithstanding the development of organizations such as the Association of Southeast Asian Nations (ASEAN), which generally might be expected to favour financial liberalization. It contrasts with financial integration in the European Union (EU), with national enthusiasm in Asia 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-Asian crisis consensus expectations that greater financial integration would help guard against future shocks or ameliorate their effects.

This paper describes 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, especially in regional trade policy, dispute resolution and monetary cooperation. It suggests that issues of governance help explain why modest financial integration accompanies generally successful economic growth and economic integration in the region. First, long-standing cultural norms and legal systems militate against innovation in 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”. This strict preference for consensuality encourages only incremental 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

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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. These factors are expected to subsist for some time, notwithstanding the agreement of ASEAN members in 2007-08 to create a legal personality for ASEAN,<sup>1</sup> and form an economic community of states by 2015.<sup>2</sup>

The paper is directly concerned only with regional financial integration and makes no attempt to address how governance standards affect financial market behaviour, for example, by influencing general expectations or asset valuations. Nor does it consider integration between Asia and elsewhere. Unless stated, references in this paper to economic or financial integration signify no transnational political objectives. Shortly before the 1957 Treaty of Rome created the European Economic Community (EEC),<sup>3</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>4</sup> requiring both free trade in goods and free movement of capital.<sup>5</sup> It is appropriate to assess East Asia’s contemporary integration over ten years after the Asian financial crisis with reference to the permissiveness of cross-border regional trade and capital flows<sup>6</sup> and to look forward in the context of the global financial crisis to possible future directions. The following section II reviews the structure of Asian financial integration in relation to issues of governance. Section III then identifies factors that help explain the extent of current financial integration, while section IV examines attempts to encourage integration in trade in financial services, cooperation in monetary policy and capital market development and integration. Section V concludes with policy recommendations, arguing that East Asia should increase efforts towards harmonization to regional standards built upon international best practices as a necessary prudential predicate to regional financial liberalization. The paper concludes by discussing future policy innovations, including the possible functions of a mooted “Asian Monetary Fund”, and asks whether the recent global crisis will make such regional initiatives more likely to come to fruition.

## II. East Asian Financial Cooperation and Governance

Financial integration is associated with capital mobility<sup>7</sup> and is the extent to which an economy’s financial system is not shielded or made distinct from other national and

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<sup>1</sup> Art. 3, Charter of the Association of Southeast Asian Nations 2007 (“ASEAN Charter”), effective 15 December 2008.

<sup>2</sup> *Declaration on the Roadmap for the ASEAN Community (2009-2015)*, 1 March 2009, online <<http://www.aseansec.org/22331.htm>>.

<sup>3</sup> Among Belgium, France, the former West Germany, Italy, Luxembourg and the Netherlands, a group that remained unchanged until 1973.

<sup>4</sup> Wilhelm Röpke, “Economic Order and International Law” (1954) 86 *Rec. des Cours* II, 251.

<sup>5</sup> *Ibid.* at 252.

<sup>6</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. 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,” *ibid.* at 258. ASEAN+3 is an ad hoc group comprising ASEAN’s members plus China, Japan and South Korea. The payments union is chronicled in Barry Eichengreen, *Reconstructing Europe’s Trade & Payments* (Ann Arbor: University of Michigan Press, 1993).

<sup>7</sup> See Fritz Machlup, *A History of Thought on Economic Integration* (London: Macmillan, 1977) at 71-72, noting also that “integration” was not used in this sense before the mid-1950s: *ibid.* 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” (1985) 45:2 *J. Econ. Hist.* 219, at

international financial markets. It is thus the antithesis of the Bretton Woods international financial system that prevailed for almost thirty years following World War II.<sup>8</sup> Such integration is difficult to identify consistently,<sup>9</sup> because it can be measured 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 production. Financial integration emphasizes wholesale activity and examines only secondarily those aspects of retail financial intermediation involving individuals.<sup>10</sup> Thus legal or customary borders to the trade in retail financial services prevail even in well-integrated regions such as the EU.<sup>11</sup>

Financial integration is also taken to refer to the extent of correlations in price performance of two or more distinct markets or systems, for example in equity securities or interest rates.<sup>12</sup> This is related to the subject of this paper 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>13</sup> and the expectation of a "full speedy adjustment of asset stocks in response to

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221 (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>8</sup> Bretton Woods required the separation of national markets to support fixed exchange rates, independent national monetary policies and general stability, see Douglas Arner, *Financial Stability, Economic Growth and the Role of Law* (New York: Cambridge University Press 2007), 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. 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 European Commission, *The EU economy: 2003 review* (Brussels: Directorate-General for Economic and Financial Affairs, European Commission, 2003) at 320, online: <[http://ec.europa.eu/economy\\_finance/publications/publication7694\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication7694_en.pdf)>.

<sup>9</sup> Apostolos Gkoutzidis, "How Far is Basel from Geneva? International Regulatory Convergence and the Elimination of Barriers to International Financial Integration" (2006) SSRN working paper, online: <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=699781](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=699781)>.

<sup>10</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>11</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* (Brussels: European Economic Community, 1966). Segré lamented the lack of progress in dismantling national barriers to financial activity but played down the political implications of financial integration.

<sup>12</sup> See e.g. Jing Chi, Ke Li & Martin Young, "Financial Integration in East Asian Equity Markets" (2006) 11:4 *Pacific Econ. Rev.* 513; Eduardo Levy Yeyati, Sergio Luis Schmukler & Neeltje van Horen, "International Financial Integration through the Law of One Price" (2006) World Bank Policy Research Working Paper No. 3897. 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 David Cowen, Ranil Salgado, Hemant Shah, Leslie Teo & Alessandro Zanello, eds., *Financial Integration in Asia: Recent Developments and Next Steps*, (2006) IMF Working Paper No. 06/196.

<sup>13</sup> William Shepherd, *International Financial Integration: History, Theory and Applications in OECD Countries* (Avebury: Aldershot, 1994) at 77-79. 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.

price changes.”<sup>14</sup> While true financial integration can be expected to lead to an international convergence of financial asset prices the analysis in this paper 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>15</sup> and despite relying upon mechanisms commonly identified as political.<sup>16</sup> It also differs from foreign direct investment (FDI), even though such infusions are often made through the purchase of shares.

The premise of this paper 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. One International Monetary Fund (IMF) study found that:

[t]otal financial liabilities in Asia (the combined stock of [FDI], foreign loans, and equity holdings) [are] 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>17</sup>

Similarly, a 2008 Asian Development Bank (ADB) report noted that while financial integration had increased after the Asian financial crisis, it had a “troubled history” and remained “patchy”,<sup>18</sup> with the region’s markets less mutually integrated than with global markets and less integrated in both respects than markets in Europe.

Evidence of a direct relationship between financial integration and economic growth is inconclusive.<sup>19</sup> This is significant in terms of state norms in Asia, given that capital

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<sup>14</sup> *Ibid.* at 78.

<sup>15</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.

<sup>16</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?” (1991) 21:2 *Brit. J. Pol. Sci.* 215, identifying policy emulation, harmonization, penetration and the existence of elite policy groups.

<sup>17</sup> Cowen & Salgado, *supra* note 12, 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.)

See also Graciela Kaminsky & Marco Cipriani, “A New Era of International Financial Integration: Global, Market, and Regional Factors” (2006) Hong Kong University School of Economics & Finance Workshop Discussion Paper No. 534.

<sup>18</sup> ADB, *Emerging Asian Regionalism: a Partnership for Shared Prosperity* (Manila, 2008) at 108. The report uses six indicators to show a post-2000 advance in regional economic integration, *ibid.* at 40-45, of which a measure of price correlations among national equity markets is most relevant to this paper.

<sup>19</sup> See Moritz Schularick & Thomas Steger, “Does Financial Integration Spur Economic Growth? New Evidence from the First Era of Financial Globalization” (2006) CESIFO Working Paper No. 1691, online: <<http://www.ssrn.com/abstract=884434>>, 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

controls were anathema to the IMF from at least the mid-1980s until they became controversial in the wake of the 1997-98 financial crisis. Since then, capital controls have been more widely favoured, partly due to their use by states such as China and Malaysia that were relatively less affected by that crisis.<sup>20</sup>

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 cultural norms operating at state or sub-state level that influence behaviour within Asia's regional institutions or organizations, as sections III and IV will suggest. 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>21</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>22</sup>

The nature of financial governance in Asia as revealed in the behaviour 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 arguably be regarded as having been achieved in spite of such norms.<sup>23</sup> Financial integration appears to require certain enabling institutions, which Asian states have historically chosen to avoid creating or allowing to function freely. Note that the development of such institutions would not affect the rights of a state to block or set conditions for inward foreign investment.

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>24</sup> and ASEAN's embracing China, Japan and South Korea, the dominant economies of Northeast Asia, through the ASEAN+3 mechanism. ASEAN was

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Philip Lane & Gian Maria Milesi-Ferretti, "International Financial Integration" (2003) IMF Working Paper No. WP/03/86 (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" (2006) Institute for International Integration Studies Discussion Paper No. 174, online: <<http://ssrn.com/abstract=925872>>.

<sup>20</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.

<sup>21</sup> See respectively *The ASEAN Declaration*, 8 August 1967, online: <<http://www.aseansec.org/1212.htm>> and *Treaty of Amity and Cooperation in Southeast Asia*, 24 February 1976, online: <<http://www.aseansec.org/1217.htm>>.

<sup>22</sup> Shanmugam Jayakumar, "Stick to Basics" (speech to ASEAN ministerial meeting, 24 July 1998), online: <<http://www.aseansec.org/3924.htm>>. 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* (Oxford: Routledge, 2001).

<sup>23</sup> Asia's economic integration was described in 1994 as having taken place "spontaneously, through business decisions without an intergovernmental framework [...] indeed, in spite of some government hostility", Vincent Cable, "Overview" in Vincent Cable and David Henderson eds., *Trade Blocs?: the Future of Regional Integration* (London: Royal Institute of International Affairs, 1994), at 6. This remains an appropriate characterisation of Asian financial integration. Most of the regional groupings formed up to 2005 in Asia are listed in Melissa Curley & Nicholas Thomas, eds., *Advancing East Asian Regionalism* (Oxford: Routledge, 2007) at 247-254.

<sup>24</sup> See notably John Ravenhill, *APEC and the Construction of Pacific Rim Regionalism* (Cambridge: Cambridge University Press, 2001).

for long unconcerned with the financial sector but began discussing regional financial matters in the mid-1990s.<sup>25</sup> This was influenced by the 1997-98 financial crisis, a consensual wish to distinguish the region 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>26</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 onset of the Asian financial crisis in early 1997.<sup>27</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 programmes and projects at their chosen pace rather than be restrained by others.<sup>28</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. Further, 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>29</sup> The intention was rehearsed during 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>30</sup>

More generally, ASEAN and ASEAN+3 states have been unprepared to relinquish the high degree of national policy control associated with weak or non-existent regional institutions and organizations. Thus the extent of regional integration is consistent with shared norms, whether deliberately adopted as with the consensual ASEAN Way, the making paramount of other aspects of state policy, or indirectly managed as with the participation of commercial and banking interests in governance. The organization of Asian capitalism in the developmental state model has been effective serially in Japan, South Korea and China in this

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<sup>25</sup> Indeed, no aspect of finance is among ASEAN's current "Priority Sectors for Economic Integration" comprising 12 industrial and service sectors, see ASEAN, *Priority Sectors For Economic Integration* (25 January. 2007), Fact Sheet 2007/AEC/002, online: <[http://www.aseansec.org/Fact Sheet/AEC/2007-AEC-002.pdf](http://www.aseansec.org/Fact%20Sheet/AEC/2007-AEC-002.pdf)>.

<sup>26</sup> *The Bangkok Summit Declaration of 1995*, 15 December 1995, online: <<http://www.aseansec.org/5189.htm>> [*Bangkok Summit Declaration*].

<sup>27</sup> *Ministerial Understanding on ASEAN Cooperation in Finance*, 1 March. 1997, online: <<http://www.aseansec.org/1939.htm>>.

<sup>28</sup> *Ibid.*, art. 5.

<sup>29</sup> Ernst Haas, "International Integration: The European and the Universal Process" (1961) 15:3 *Int. Org.* 372 [*Haas, "International Integration"*].

<sup>30</sup> *ASEAN Vision 2020*, 15 December. 1997, online: <<http://www.aseansec.org/1814.htm>>.

respect, characterized by close directional relationships between the state and leading commercial interests.<sup>31</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, serving private as well as public interests.<sup>32</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>33</sup>

The most dramatic result of subsuming regionalism to national policy objectives is seen in the accumulation of international reserves in the region after 2000, partly as a consequence of the primacy of national exchange rate policies over financial integration or regional market development. The shared commitments and policies implicit in financial regionalism are constrained by national objectives.<sup>34</sup> The relative forcefulness of national policy has long been recognized in the context of regional integration, as “[o]rganizations 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>35</sup>

Yet most states adopted similar national post-crisis policies and risk averse asset accumulation that would appear to be highly 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>36</sup>

### **III. Cooperation and Integration: Underlying Factors**

Four factors have encouraged discussions and initiatives in Asian financial cooperation, integration and governance over the last decade. These relate especially to the 1997-98 financial crisis aftermath, but also to growing economic integration, developmental issues, and certain political influences. The means by which these factors encouraged integration are relevant to the policy formation processes customarily used by Asia’s regional bodies.

#### **A. Asian Crisis Imperatives**

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<sup>31</sup> See especially S. Gordon Redding, *The Spirit of Chinese Capitalism* (New York: W. de Gruyter, 1990).

<sup>32</sup> Fredrik Soderbaum, “Modes of Regional Governance in Africa: Neoliberalism, Sovereignty Boosting, and Shadow Networks” (2004) 10 *Global Governance* 419.

<sup>33</sup> Joseph Nye & Robert Keohane, “Transnational Relations and World Politics: an Introduction” (1971) 25:3 *Int. Org.* 329.

<sup>34</sup> This is illustrated by the portion of ASEAN+3 international reserves pooled in a regional integration initiative representing only 0.15 per cent of the total when created at end-2005.

<sup>35</sup> Ernst Haas, “The Study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing” (1970) 24:4 *Int. Org.* 607, at 616.

<sup>36</sup> Robert Keohane, “From Interdependence and Institutions to Globalization and Governance”, in Robert O. Keohane, *Power and Governance in a Partially Globalized World* 1-23 (London and New York: Routledge, 2002).

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>37</sup> The crisis also induced a lasting risk aversion among policymakers fearful of similar instability and external interference in domestic governance in future. 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 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 previously adopted minimal controls on capital inflows.<sup>38</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>39</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 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 in each case but provided on output-reducing terms and without concern for non-interference in state governance. Thailand had sought bilateral 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 programmes, 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 (AMF) 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>40</sup> Changes to domestic policies required by

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<sup>37</sup> And induced officials in Japan to propose certain new regional institutions, including a monetary fund, see Shigeko Hayashi, *Japan and East Asian Monetary Regionalism: Towards A Proactive Leadership Role* (Oxford and New York: Routledge, 2006) at 82-102. See also William Grimes, *Currency & Contest in East Asia: The Great Power Politics of Financial Regionalism* (Ithaca: Cornell University Press, 2009) at 76-82 [Grimes, *Currency & Contest*].

<sup>38</sup> China's post-crisis economic and financial experience may also have been protected by a substantial currency devaluation in 1994.

<sup>39</sup> See Asli Demirgüç-Kunt & Enrica Detragiache, "Financial Liberalization and Financial Fragility" (1998) World Bank Working Paper No. 1917, 12, online: <<http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1900series/wps1917/wps1917.pdf>>.

<sup>40</sup> A narrative of Japan's policy response to the financial crisis appears in Hayashi, *supra* note 37, at 82-102.

the IMF in 1997-98 before granting credit to Indonesia, South Korea and Thailand are remembered as profoundly disturbing to many states in the region.

Thus the Asian financial crisis not only revealed weaknesses in national financial systems, but also in imperfect and entrenched regional economic and financial linkages that made each economy vulnerable to contagion from major 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 most changes were modest with the exceptions of China, South Korea and Malaysia, 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 first meaningful attempt to relax ASEAN's doctrine of mutual non-interference when Thailand proposed in 1997-98 a policy of "flexible engagement" to signify deliberate interaction among member states. The requirements and implications were not fully 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, 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>41</sup>

The suggestion that capital mobility might eventually be far freer acknowledges the limits that members set for financial integration. Nothing in these remarks addresses the effectiveness 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 instability in Thailand's external relations.<sup>42</sup>

Regional initiatives prompted by the 1997-98 crisis but not carried into tangible financial regionalism for reasons discussed in this section have been given fresh incentives, or disincentives to their implementations lessened, by the global financial crisis that began in August 2007.<sup>43</sup>

## **B. Economic Imperatives**

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 acquisition financing) and requirements for

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<sup>41</sup> Jayakumar, *supra* note 22 [emphasis added].

<sup>42</sup> Notwithstanding the common objectives expressed in ASEAN's "Vision 2020". Plans announced by ASEAN+3 in May 2009 to reform its Chiang Mai Initiative arrangements of central bank credit lines include provision for lending decisions to be made by majority rather than a traditional consensus. The form of majority has yet to be disclosed.

<sup>43</sup> The foremost example is a commitment to monetary policy cooperation.

credit, 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 integration highlights an array of impediments to regional and national financial activity.<sup>44</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 Imperatives

The most visible part of East Asia's post-2000 response to its regional financial crisis was a precautionary accumulation of low risk non-Asian financial assets. This may not have been an overt objective of policy for any single state but was closely connected to deliberate national currency and economic management over the period.<sup>45</sup> State actors now control very substantial foreign reserves but the scale of their accumulation has prompted concerns as to risk concentration, the role of global financial imbalances in the global financial crisis of 2007-2009,<sup>46</sup> and whether certain of those resources might be allocated to Asian risks and support for welfare spending or infrastructural development. Furthermore, many Asian economies have comparatively high rates of consumer and corporate 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, as became clear in 1997-98.

One possible development imperative thus focuses on building deep and transparent financial markets to allow broader uses of foreign reserves within the region, and apply domestic savings better to support capital investment. Other examples include using reserves to endow new sovereign wealth funds, or semi-autonomous state investment vehicles.<sup>47</sup> These have commonly used investment allocation and governance models associated with well-established funds in Gulf states or Singapore and while not sharing common objectives have tended to be passive, risk averse and invested largely in non-Asian companies and real estate.<sup>48</sup> It would be a departure for Asia's sovereign wealth funds to devote resources to

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<sup>44</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* (Singapore: Institute of Southeast Asian Studies, 2006).

<sup>45</sup> No single factor explains the growth in aggregate Asian reserves since 2000, see Yin-wong Cheung & Hiro Ito, "Hoarding of International Reserves: A Comparison of the Asian and Latin American Experiences" (2008) Hong Kong Institute for Monetary Research Working Paper No.7/2008, online: <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1160924](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1160924)>. Traditional motives include commercial trade transaction demand, capital inflows through foreign direct investment, precautionary behaviour and mercantilist policies, with the latter two factors cited in this sub-section.

<sup>46</sup> For discussion, see Douglas Arner, "The Global Credit Crisis: Causes and Consequences" (2009) 43 *The International Lawyer* 91.

<sup>47</sup> See especially Gerald Lyons, "State Capitalism: The Rise of Sovereign Wealth Funds", submission to US Senate Committee on Banking, Housing, and Urban Affairs, 13 November 2007, online: <<http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=4c63b142-fd5c-4b82-aff9-75e254271056>>.

<sup>48</sup> Bernardo Bortolotti, Veljko Fotak, William Megginson & William Miracky, "Sovereign Wealth Fund Investment Patterns and Performance" (2009) Fondazione Eni Enrico Mattei working paper No. 22, online <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1108585](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1108585)>.

regional development. In any event, applying resources to regional development is distinct from the issue of encouraging financial development through crisis avoidance.

#### **D. Political Imperatives**

Politics is a pervasive influence on the extent and character of financial integration but beyond the direct scope of this paper. Both the relative competitive position of states and their historic rivalries are highly significant in discussions on regional integration. China's growing influence is now arguably encouraging smaller states (and Japan) to favour enhanced mutual cooperation for reasons of economic security. This includes balancing the influence of China by engaging with Australia, India and New Zealand in the ASEAN+6 or East Asian Summit (EAS) process. Similar thinking underlies a wish to counter the political-economic weight of the EU and United States and excessive reliance on their currencies, especially the US dollar which has long been the dominant anchor for regional transactions and regional transactions in international markets. Discussions of economic and financial cooperation and integration and of governance issues among ASEAN and ASEAN+3 actors are significantly impacted by these considerations, and the EAS is a direct result. At the same time, such efforts may be dissipated by the proliferation of bilateral trade agreements within the region, notwithstanding a more constructive view that Asia's "noodle bowl" network of such treaties may serve as building blocks for universal free trade.<sup>49</sup>

Pressure from the EU and United States has prevented ASEAN from responding collectively to representations on its admission of Myanmar, for example, and in responding to Japan's regional initiatives after the Asian financial crisis.<sup>50</sup> Broader security cooperation has been seen as one of "three pillars" that might support more intense Asian political integration,<sup>51</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>52</sup> such benefits being most apparent in political and security matters.

#### **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>53</sup> By this measure, regional channels may be seen as comparatively weak.

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<sup>49</sup> Richard Baldwin, "Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade" (2006) NBER Working Paper No. 12545, online: <<http://www.nber.org/papers/w12545>> [Baldwin, "Multilateralising Regionalism"].

<sup>50</sup> An alternative view is that Japan has "limited incentives to invest in regional cooperation," per Natasha Hamilton-Hart, "Financial Cooperation and Political Economy" in Curley & Thomas, *supra* note 23 at 132, due to its having "an economy still much more domestically orientated than that [sic.] of its neighbours," *ibid.*, and since Japanese cooperation proposals (such as those for monetary cooperation or an AMF) stems from "relatively insulated policy-makers and academics" who lack support at home: *ibid.* 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>51</sup> Curley & Nicholas Thomas, "Introduction", in Curley & Thomas, *supra* note 23 at 17-19.

<sup>52</sup> See e.g., Ravenhill, *supra* note 24 at 27; Evelyn Goh & Amitav Acharya, "The ASEAN Regional Forum and Security Regionalism: Comparing Chinese and American Positions", in Curley & Thomas, *supra* note 23 at 96-115.

<sup>53</sup> See Bennett, *supra* note 16.

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

Asian financial integration has been subject to considerable but equivocal attention, reflecting the lagging of financial integration behind economic integration described in section II. Here, the region's transnational organizations are important for two reasons. First, they represent extant regional institutions and their limitations illustrate a lack of commitment to regional governance; second, they have supported national actors with funding and technical assistance for financial reform. Initiatives to encourage financial integration have particularly addressed trade in financial services, cooperation in external monetary operations and capital market development.<sup>54</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 greater benefits in utility and crisis prevention, treating regional development as secondary. Asian policymakers may be more malleable but the historical result of such differences has been reform taking place in the forum of least resistance. Thus ASEAN+3 has addressed regional development issues to which the United States was opposed while APEC simultaneously dealt with proposals that the United States might endorse, including domestic market development. In the second case, post-crisis proposals were developed by APEC and the ADB to establish a well-capitalized regional financial guarantor to provide credit enhancement for structured transactions but lapsed due to opposition of non-Asian participants or ADB shareholders.<sup>55</sup> This paper's view is that domestic and regional approaches to reform have merit and may be mutually reinforcing, a view echoed by experiences in the EU (arguably reinforced during the global financial crisis of 2007-2009).

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

Limited growth has occurred in the regional trade in financial services and any 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 based upon the ASEAN+6 forum that may become a framework for wider cooperation.

#### **1. AFTA**

ASEAN activity includes heads of government summits, ministerial meetings and work in ad hoc committees. The organization historically has been less prominent in economic affairs although persistence has helped inculcate a positive image as a collaborative forum. ASEAN

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<sup>54</sup> Japan's strategies for financial cooperation including reforming taxation through a web of new treaties are beyond the scope of this analysis.

<sup>55</sup> ASEAN+3 also failed to support the proposal. It was revived in May 2009 with ASEAN+3 agreeing to capitalize a US\$500 million trust fund for a similar purpose. A regional guarantor would formerly have competed with mainly US commercial monoline insurers that lost influence as their creditworthiness collapsed in 2007-08. Non-Asian interests were also concerned at the cost of capitalizing a commercial vehicle to provide regional credit enhancement, see Paul Lejot, Douglas Arner & Frederic Pretorius, "Promoting Market Development with Structured Finance and Regional Credit Enhancement" at 284-5 in Douglas Arner, Jae-Ha Park, Paul Lejot & Qiao Liu eds., *Asia's Debt Capital Markets: Prospects and Strategies for Development* (New York: Springer, 2006).

finance ministers first met to discuss regional cooperation in 1967.<sup>56</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>57</sup>

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

Any conceptual success in AFTA obscures its institutional deficit 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>58</sup> the breadth of language of which makes it doubtful that it constitutes a treaty among its signatories.<sup>59</sup> AFTA's substantive initiating agreement set objectives for removing tariffs and non-tariff barriers,<sup>60</sup> and modifications set the goal of eliminating all import duties by 2015.<sup>61</sup> Similar objectives were adopted within ASEAN+3 so that China-ASEAN and Japan-ASEAN free trade areas are in formation and a Korea-ASEAN free trade area is now largely established.<sup>62</sup>

## 2. AFAS financial services sector commitments

ASEAN's 1995 Framework Agreement on Services (AFAS)<sup>63</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). The commitments are not confined to allowing foreign access only to ASEAN members.

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>64</sup> and the additional access granted to foreign interests in most

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<sup>56</sup> Producing the *Ministerial Understanding on ASEAN Cooperation in Finance*.

<sup>57</sup> *Bangkok Summit Declaration*.

<sup>58</sup> AFTA appears in only one of the 15 clauses of the *Framework Agreement on Enhancing ASEAN Economic Cooperation*, 28 January 1992, online: <<http://www.aseansec.org/12374.htm>>.

<sup>59</sup> Jacques Pelkmans, "ASEAN and APEC, A Triumph of the 'Asian Way'?" in Paul Demaret, Jean-Francois Bellis & Gonzalo Garcia Jimenez, eds., *Regionalism and Multilateralism after the Uruguay Round: Convergence, Divergence and Interaction* (Brussels: European Inter-University Press, 1997) at 211.

<sup>60</sup> *Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area*, 28 January 1992, online: <<http://www.aseansec.org/12375.htm>>.

<sup>61</sup> Brunei, Indonesia, Malaysia, 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>62</sup> See generally ASEAN Free Trade Areas, online: <<http://www.aseansec.org/4920.htm>>. A Korea-ASEAN free trade area became effective in principle with the signing of the *Agreement on Investment under the Framework Agreement on Comprehensive Economic Cooperation* [between] ASEAN and Korea, 2 June 2009, and settlement in February 2009 of tariff disputes between Korea and Thailand, online: <<http://www.aseansec.org/22557.htm>>.

<sup>63</sup> 15 December 1995, art. IV, online: <<http://www.aseansec.org/6628.htm>>. Certain financial sector requirements commitments were strengthened in 2002-03: *Protocol to Amend the ASEAN Financial Services Agreement*, 2 September 2003, online: <[http://www.aseansec.org/AFAS\\_Amendment\\_Protocol.pdf](http://www.aseansec.org/AFAS_Amendment_Protocol.pdf)>.

<sup>64</sup> See respectively GATS/SC/95, GATS/SC/43/Suppl.3, and WT/ACC/KHM/21/Add.2/.

cases is limited. A 2006 assessment of AFAS commissioned by ASEAN and Australia's official Regional Economic Policy Support Facility concluded that its performance was both disappointing and unimpressive.<sup>65</sup>

### 3. APEC

Meetings of APEC finance ministers began in 1993, prior to which Japan and the United States resisted its 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 the trade in financial services issues is circumscribed and accords with the characterization of APEC as ineffectual,<sup>66</sup> favouring 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 reform. While APEC was thought an effective forum for economic concerns prior to the 1997-98 crisis, it has been seen since as less successful, and 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>67</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 favour of stable capital flows, domestic financial market development, efforts to promote financial stability, and work to strengthen the regulation of international financial intermediaries and increase cooperation among regulators to lessen global systemic risks.<sup>68</sup> No objection can be made to these pronouncements but APEC's contribution to tangible 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>69</sup> progressed in 2000 to an intention to study integration including a formal free trade area,<sup>70</sup> and led in 2001 to the creation of an expert group for ASEAN-China economic cooperation. ASEAN and China concluded a Framework Agreement on Comprehensive Economic Cooperation (ACFTA) in 2002,<sup>71</sup> followed by agreements covering the trade in goods in 2004 and for

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<sup>65</sup> Vo Tri Thanh & Paul Bartlett, Ten Years of ASEAN Framework Agreement on Services (AFAS): An Assessment (2006) at 6, online <<http://www.aseansec.org/16945.htm>>.

<sup>66</sup> See Ravenhill, *APEC*, *supra* note 24.

<sup>67</sup> See Sixth APEC Ministerial Meeting, Joint Statement, (11-12 November 1994), online: <[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)>.

APEC's Non-binding Investment Principles issued in 1994 are not only non-binding but insubstantive, *ibid*. 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." *Ibid*. There is no more recent or specific APEC examination of cross-border investment.

<sup>68</sup> By the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

<sup>69</sup> At the first Meeting of Common Commission of Economic and Trade Cooperation between China and ASEAN.

<sup>70</sup> Proposed by China at a China-ASEAN summit meeting.

<sup>71</sup> Amended in 2003, see *Protocol to Amend the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China*, 6 October 2003, online: <<http://www.aseansec.org/15157.htm>> [*Framework Agreement*].

investments in property, certain intangible assets, and financial securities in 2009.<sup>72</sup> These agreements stipulate that a free trade area will come into effect in 2010 for China and ASEAN's five founding members and Brunei, and expand in 2015 to include Cambodia, Laos, Myanmar and Vietnam.

ACFTA has four objectives: to 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>73</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>74</sup>

ACFTA and AFTA are independent. The establishment of ACFTA represents a separate free trade agreement (FTA) 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 have lagged 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 has for AFTA.

## **5. ASEAN-ANZ FTA agreement**

In February 2009 ASEAN's members signed free trade agreements with Australia and New Zealand and an agreement establishing the ASEAN-Australia-New Zealand Free Trade Area (ASEAN-ANZ FTA). The latter embraces trade in goods, services (including finance and telecommunications), electronic commerce, movement of natural persons, and investment, and is generally regarded as part of the region's response to the 2007-08 global financial crisis.<sup>75</sup> The Annex on Financial Services to the ASEAN-ANZ FTA agreement applies to measures affecting financial services, including insurance and banking. In addition to a general prudential carve-out clause in Article 3 of the Annex on Financial Services, a further clause enables member states to adopt or enforce measures necessary to ensure compliance with domestic laws or regulations, especially in the prevention of deceptive or fraudulent practices or deal with the effects of defaults on financial services contracts.<sup>76</sup>

### **B. Monetary Cooperation**

Regional monetary cooperation was until recently evidenced by short-term bilateral ASEAN+3 credit lines. As noted above, an AMF was mooted during the 1997-98 crisis but abandoned upon intense US opposition.<sup>77</sup> New arrangements may have become more tangible

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<sup>72</sup> See respectively, *Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and China*, 29 November 2004, online: <<http://www.aseansec.org/16646.htm>>, including an agreement on dispute settlement mechanisms, online: <<http://www.aseansec.org/16635.htm>>; and *Agreement on Investment of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China*, 15 August 2009, online: <<http://www.aseansec.org/19105.htm>>.

<sup>73</sup> *Framework Agreement*, arts. 1 & 2.

<sup>74</sup> *Ibid.*, arts. 4 & 5.

<sup>75</sup> Joint Media Statement on the signing of the agreement establishing the ASEAN-Australia-New Zealand Free Trade Area, 27 February 2009, online: <<http://www.aseansec.org/22255.htm>>.

<sup>76</sup> Financial Services Exception, see art. 6, Annex on Financial Services, ASEAN-ANZ FTA.

<sup>77</sup> A regional monetary fund was discussed again within ASEAN+3 in April 2006 in terms of benefits associated with long-term currency alignments or and monetary union.

due to the 2007-08 global financial crisis enhancing Asia's comparative economic and political standing, and re-emphasizing the region's exposure to non-Asian currency risks.

## 1. The Chiang Mai Initiative to 2009

The 2000 ASEAN+3 Chiang Mai Initiative (CMI) was intended to promote regional cooperation by means of bilateral currency swap agreements among central banks.<sup>78</sup> The current network of sovereign bilateral credit lines has two roots:<sup>79</sup> collaborative foreign exchange swap lines set up 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>80</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>81</sup> The scheme was renewed and expanded, and may have been utilized once each by Indonesia, Malaysia, the Philippines and Thailand between 1979 and 1981, and once again by the Philippines in 1992, in all cases for modest amounts.<sup>82</sup> Use of the lines required prior IMF agreement with the debtor state. The arrangement's limited size and conditionality prevented its use in 1997 when the members' external positions were most under pressure.

EMEAP's bilateral repo lines were introduced in 1995-97. Japan was active in their creation, partly due to its interest in promoting regional blocs 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>83</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 repo lines is prolific among both commercial and central banks, but EMEAP's lines are analogous to the conduct by central banks seeking to influence domestic liquidity, including cases where a central bank accepts collateral in the form of prescribed securities for provision of liquidity support. This became a tactic of leading central banks after the credit dislocation caused by Lehman Brothers' failure in September 2008. Use of EMEAP repo lines has no direct consequence for domestic credit expansion.

Excluding those involving Australia and New Zealand, two original sets of lines evolved after 2000 into more complex agreements known as CMI.<sup>84</sup> This led ASEAN

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<sup>78</sup> See *Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting*, 6 May 2000, online: <<http://www.aseansec.org/635.htm>>.

<sup>79</sup> Counterparty risk is taken here as sovereign whether it involves a central bank or finance ministry.

<sup>80</sup> Reported by Ramon Moreno, "Dealing with Currency Speculation in the Asian Pacific Basin", *Fed. Reserve Bank San Francisco Econ. Letter*, (11 April 1997), 97-10.

<sup>81</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>82</sup> See C. Randall Henning, *East Asian Financial Cooperation* (Washington, D.C.: Institute for International Economics, 2002) at 14, 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* (UNESCAP, 2003), at 90.

<sup>83</sup> See Moreno, *supra* note 80.

<sup>84</sup> CMI is subject to no single public agreement to which all its adherents are party.

members (increased to ten) to raise their swap arrangement to US\$1.0 billion (US\$2.0 billion from 2005, known as the ASEAN Swap Arrangement or ASA) and for China, Japan and South Korea to create bilateral credit lines allowing for currency swaps and securities repurchases among themselves and with the five larger ASEAN economies.<sup>85</sup> The initiative was not a formal agreement but an expression of intent, making ASEAN+3 a catalyst for bilateral arrangements already customary among developed economies.<sup>86</sup>

CMI's results blend purposeful display with practical confusion.<sup>87</sup> First, the 16 bilateral lines established by China, Japan and South Korea entailed terms that make IMF sanction mandatory for 80 per cent of usage, not merely the satisfaction of conditions precedent identical to those customarily demanded by the IMF.<sup>88</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 lapsed. In a similar instance in mid-1997, Thailand is thought to have used a precursor swap line with Japan.<sup>89</sup> If so, this failed to influence markets intent on selling the baht since drawing from a

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<sup>85</sup> Japan's finance ministry has disclosed that no lines exist between Singapore and either China or Japan; that not all CMI bilateral agreements contain symmetrical commitments, for example, Japan's line for Thailand is twice that of Thailand's for Japan, and other lines have a single obligor rather than being available to both parties; and that lines agreed between China, Japan and South Korea, and that extended by China to the Philippines would be drawn in the creditor's currency rather than US dollars, see online: <[http://www.mof.go.jp/english/if/regional\\_financial\\_cooperation.htm#CMI](http://www.mof.go.jp/english/if/regional_financial_cooperation.htm#CMI)>. Implementation of the ASA by Cambodia, Laos, Myanmar and Vietnam has to date been waived.

<sup>86</sup> CMI totalled US\$92.0 billion equivalent as at May 2009, all but US\$2.0 billion consisting of non-ASEAN bilateral swap lines of which 49 per cent is committed by Japan (excluding a US\$20.0 billion temporary increase in Japan's line for Korea at the peak of the 2008 credit crisis), see Ministry of Finance of Japan, "Regional Financial Cooperation among ASEAN+3", online: <[http://www.mof.go.jp/english/if/regional\\_financial\\_cooperation.htm](http://www.mof.go.jp/english/if/regional_financial_cooperation.htm)>.

<sup>87</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), online: <<http://www.mof.go.jp/jouhou/kokkin/ASEAN+3research.htm>>.

<sup>88</sup> A fuller narrative of decision making and surveillance under CMI appears in Grimes, *Currency & Contest*, *supra* note 37 at 85-9. In May 2005 ASEAN+3 raised the portion available unconditionally under post-CMI swap lines from 10 to 20 per cent 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 *Joint Ministerial Statement of the 8<sup>th</sup> ASEAN+3 Finance Ministers' Meeting*, 4 May 2005, online: <<http://www.aseansec.org/17448.htm>>. It is arguable that IMF compliance would be demanded for usage even had it not then made credit commitments to a hopeful user. Japan's current bilateral agreement with Singapore allows line usage of up to 20 per cent "without [the drawer] tapping on an IMF-supported programme", see *Joint Press Release, Ministry of Finance of Japan, The Bank of Japan and the Monetary Authority of Singapore*, November 9, 2005, online: <[http://www.mof.go.jp/english/if/051109press\\_release.htm](http://www.mof.go.jp/english/if/051109press_release.htm)>. Japan's more recent practice has been less stringent, so that a non-CMI agreement with India:

will be activated when an IMF-support program already exists or is expected to be established in the near future. Nevertheless, up to 20 percent of the maximum amount of drawing could be disbursed without an IMF-support program.

See *Joint Press Release, Ministry of Finance of Japan, Bank of Japan, Ministry of Finance of India, Reserve Bank of India*, 30 June 2008, online: <[http://www.mof.go.jp/english/if/080630press\\_release.htm](http://www.mof.go.jp/english/if/080630press_release.htm)>. This condition is similar to that contemplated by CMI's successor CMIM. It has been suggested that bilateral lines established by Japan prior to 2005 may have included additional conditions for use such as the creditor maintaining minimum reserve-import coverage ratios, see William Grimes, "East Asian Financial Regionalism in Support of the Global Financial Architecture? The Political Economy of Regional Nesting" (2006) 6 *J. East Asian Studies* at 361. Note that terms of CMI lines not involving Japan are undisclosed.

<sup>89</sup> *The Economist*, 10 May 2001 (cited by Henning, *supra* note 82).

finite source could only encourage the seller.<sup>90</sup> Similarly, CMI remained unused on occasions after 2005 when several ASEAN states experienced external instability, and credit concerns may have made certain ASEAN members unwilling to contribute to informally requested drawings.

Second, although the post-CMI lines provided by China, Japan and South Korea allow for securities repurchases, this function became seen as outmoded and was given little attention compared to the currency swap provisions.<sup>91</sup> The largest non-cash component of Asia's international reserves is held in US government securities, and critics suggest that the liquidity available through repos could not compete with such an archetypal broad and deep market.<sup>92</sup> However, this approach neglects shocks not initially focused on Asia, as in October 1987 or September 2008. In each case in the days following profound losses of confidence in stock or credit markets, trading in US Treasuries was disrupted, highly illiquid, largely closed to foreign participants and feasible among domestic primary dealers only by negotiation. Intra-Asian repo lines could have an insulatory value in such circumstances by promoting non-domestic liquidity, providing a distinct regional utility and a stabilizing emergency market among creditworthy offshore counterparties, despite reserves being concentrated in US dollar assets. That the 1995-97 repo lines were barely used, if at all, in the 1997 crisis was due either to a scarcity of collateral or to the participants simultaneously suffering similar problems that were not amenable to mutual resolution. Prevailing conditions have changed markedly with the substantial accumulation of reserves in ASEAN+3.

The impact of CMI is described by ASEAN+3 as regional and involves a gesture to harmonization and shared views of crisis avoidance, but even the ASA component is bilateral in creation and use, especially since any state may veto new or renewed drawings. 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>93</sup>

Market practitioners view the post-2000 CMI 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 commercial selling and may give confidence to the seller. It is ironic that CMI's co-option of IMF conditions has made credit line usage unlikely, as some participants may have perhaps intended, and that the older repurchase lines are neglected despite their possible usefulness in crises.

## **2. A Multilateralized Chiang Mai Initiative**

As the global financial crisis intensified in mid-2008, ASEAN+3 began planning an arrangement to pool reserves in a more institutionalized form.<sup>94</sup> The results announced by ASEAN+3 finance ministers in February and May 2009 may eventually prove a more notable

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<sup>90</sup> This lack of utility distinguishes CMI from the European Payments Union. The latter helped solve specific post-1945 external payments problems in a setting of rigid capital controls and fixed exchange rates, see also Barry Eichengreen, *The European Economy Since 1945: Coordinated Capitalism and Beyond* (Princeton: Princeton University Press, 2007), at 79-85.

<sup>91</sup> Despite being similar to well-established collateralization practice in certain derivative markets.

<sup>92</sup> E.g., Henning, *supra* note 82 at 22.

<sup>93</sup> *Joint Ministerial Statement of the 3<sup>rd</sup> ASEAN Finance Ministers Meeting*, 20 March 1999, online: <<http://www.aseansec.org/742.htm>>.

<sup>94</sup> *Joint Ministerial Statement of the 11<sup>th</sup> ASEAN+3 Ministers Meeting*, 4 May 2008, online: <<http://www.aseansec.org/21502.htm>>.

collaborative step in financial policy than previously taken by the region, although the projected commitment of US\$120 billion is modest compared to available national resources. Known as the Multilateralized Chiang Mai Initiative (CMIM), the plan will replace CMI's network of lines with a single commercial agreement, adding dedicated resources for surveillance and administration separate from those of participating states, autonomy in setting conditions for use that is distinct from CMI's association with IMF practice and good standing, and provision for majority voting by member states in certain non-trivial decision-making. When made effective CMIM may represent a considerable gain in confidence building for regional institutions.

China, Japan and South Korea will together provide 80 per cent of the facility and ASEAN members the remainder, with the scheme to become effective by 2010.<sup>95</sup> CMIM would be subject to a contractual agreement setting out the rights and obligations of participants, but it is unclear whether (and unlikely that) this would have the force of law associated with a conventional treaty. Indeed, the scale of resources involved may be limited in order to allow member states to engage in CMIM as though part of their respective central banks ordinary activities, and its exact terms may remain undisclosed.

ASEAN+3 described CMIM in May 2008 as a US\$80 billion "self-managed reserve pooling arrangement governed by a single contractual agreement".<sup>96</sup> In the following 12 months, the global crisis encouraged a larger and more far-reaching scheme. In May 2009, ASEAN+3 declared that members had:

reached agreement on all the main components of the CMIM, including the individual country's contribution, borrowing accessibility, and the surveillance mechanism.<sup>97</sup>

CMIM was to be a contract to which 13 states and Hong Kong would become party, with members making the pre-determined commitments shown in the following table. These represent contingent claims against each member's international reserves. Participants will receive borrowing limits based on fixed multiples of their respective contributions.

Table 2: Scale of Chiang Mai Initiative Multilateralisation (US\$ billions)

	Initial commitment	Borrowing multiple	Borrowing limit
Japan	38.4	0.5	19.2
China	34.2	0.5	17.1
South Korea	19.2	1.0	19.2
Indonesia			
Malaysia	4.77	2.5	11.925
Singapore			
Thailand			
Hong Kong <sup>98</sup>	4.20	2.5	10.5

<sup>95</sup> *Ibid*; Report from the Finance Ministers of the ASEAN+3 to Heads of States/Governments, 22 February 2009, online: <<http://www.aseansec.org/22158.htm>>; Joint Media Statement of the 12<sup>th</sup> ASEAN+3 Finance Ministers Meeting, 3 May 2009, online: <<http://www.aseansec.org/22536.htm>>.

<sup>96</sup> Joint Ministerial Statement of the 11<sup>th</sup> ASEAN+3 Ministers Meeting.

<sup>97</sup> Joint Media Statement of the 12<sup>th</sup> ASEAN+3 Finance Ministers Meeting.

<sup>98</sup> Part of China's contribution will be made by Hong Kong, which holds separate international reserves. Hong Kong's commitment would be fully available in CMIM without IMF conditionality. Involving Hong Kong for its technical resources may have value but the territory's inclusion in CMIM is primarily to balance the perceived statuses of China and Japan.

Philippines	3.68	2.5	9.2
Vietnam	1.0	5.0	5.0
Cambodia	0.12	5.0	0.6
Myanmar	0.06	5.0	0.3
Brunei	0.03	5.0	0.15
Laos	0.03	5.0	0.15
Totals	120.0		129.1

CMIM is larger than its antecedents but smaller in scale than external support facilities to have seen use. The IMF and ADB gave credit commitments in 1997-98 to Indonesia, South Korea and Thailand totalling US\$25.0 billion, US\$35.3 billion and US\$6.7 billion, respectively,<sup>99</sup> while Hong Kong sold more than US\$15 billion of reserves to purchase shares and equity derivatives in August 1998.<sup>100</sup> After the collapse of Lehman Brothers, the New York Federal Reserve opened peer-to-peer swap lines to provide G-7 and other central banks with offshore US dollar liquidity, for example, with Japan initially for US\$60 billion and with South Korea and Singapore each for US\$30 billion.<sup>101</sup>

Formal and public implementation of CMIM requires agreement on details of decision-making, the commitment of operational resources, and procedures for risk management, including approval mechanisms, permissible uses of lines, and surveillance of the credit standing and macroeconomic performance of members. These factors will determine the usefulness of the scheme and the extent to which CMIM will represent Asia's first original contribution to the international financial architecture, and a milestone in regional financial integration.

At inception, 20 per cent of the aggregate amount available for drawing would be "de-linked" from specific IMF conditionality but subjected to rules to be developed by ASEAN+3 members.<sup>102</sup> These include retaining the ASA option of allowing states to refrain from participating in drawings. However, ASEAN+3 intends CMIM to "supplement the existing international financial arrangement",<sup>103</sup> which requires rules for usage sufficiently robust and well understood so as not to erode market confidence in either the scheme or a user in need of liquidity. ASEAN+3 stresses that usage would be subject to "rigorous principles".<sup>104</sup> As part of the plan:

the regional surveillance mechanism should be further strengthened into a robust and credible system which will facilitate prompt activation of the CMIM. An independent regional surveillance unit will be established to promote objective economic monitoring.<sup>105</sup>

Details of mechanisms for usage or surveillance are yet to be decided, as well as what ASEAN+3 will regard as "independent". A surveillance process would precede new or

<sup>99</sup> IMF, *Commitments and Disbursements of the International Community in Response to the Asian Crisis*, online: <<http://www.imf.org/external/np/exr/ib/2000/062300.htm#table>>. In addition, bilateral commitments totalling US\$54.7 billion were made to these states, *ibid*.

<sup>100</sup> Joseph Yam, Chief Executive, Hong Kong Monetary Authority, "Coping With Financial Turmoil" (speech, 23 November 1998), online: <[http://www.info.gov.hk/hkma/eng/speeches/speechs/joseph/speech\\_231198b.htm](http://www.info.gov.hk/hkma/eng/speeches/speechs/joseph/speech_231198b.htm)>.

<sup>101</sup> See online: <<http://www.federalreserve.gov/newsevents/press/monetary/2008monetary.htm>>. The line for Japan was quickly raised to US\$120 billion and soon after made unlimited.

<sup>102</sup> *Joint Media Statement of the 12th ASEAN+3 Finance Ministers Meeting*.

<sup>103</sup> *Ibid*.

<sup>104</sup> *Report from the Finance Ministers of the ASEAN+3 to Heads of States/Governments*.

<sup>105</sup> *Ibid*.

renewed drawings and either be ongoing or specific to requests for credit. For the scheme to be credible and capable of objective use the process must be separated from existing national resources and extend beyond the collaborative arrangements to which ASEAN is accustomed. CMIM cannot be both a consensual construct typical of ASEAN+3 and independent in its core operations, but a more qualified arrangement would not be unique among international financial bodies. For example, the Financial Stability Board (FSB) has a surveillance mission but limited dedicated resources, relying on work to a large extent conducted by its national or transnational member organizations.<sup>106</sup> Credible independence results from the FSB being separate from any single member organization or member faction, rather than a self-resourced organization fully responsible for its own activity.

CMIM's surveillance and reporting tasks will be less demanding only by being concerned with fewer states or territories. The ADB's Office of Regional Economic Integration (OREI) was asked in May 2009 to develop CMIM surveillance mechanisms and identify their operating needs, although it is undecided whether this will be permanent or if OREI recommendations will result in the creation of a new regional agency or the outsourcing of operational functions to existing transnational or academic organisations. The results may not be fully disclosed but would also limit CMIM's independence and usefulness, especially given that severing connectivity with IMF conditionality is one objective of the 2008-09 decisions. The ASEAN+3 finance ministers state that when:

the [...] surveillance mechanism becomes fully effective in its function, the IMF de-linked portion [of the CMIM] may be increased above the current limit of 20 percent.<sup>107</sup>

CMIM may be criticised as ambitious but comparatively free of detail. The May 2009 statement records milestones that may lead to a demanding objective of some form of regional liquidity cooperative pact, and the credibility of the ASEAN+3 intentions for CMIM will be tested both by its practicality and speed of implementation. The operational readiness of CMIM as an independent institution is unlikely to be completed quickly, however important it may be to policymakers. Not only are details of its operating mechanics and specific purposes yet to be decided, but the concept is more demanding than any previous

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<sup>106</sup> FSB tasks include:

to assess vulnerabilities affecting the financial system, identify and oversee action needed to address them; [...] monitor and advise on market developments and their implications for regulatory policy; [and] advise on and monitor best practice in meeting regulatory standards.

Art. 2(1), Financial Stability Board Charter, effective 25 September 2009, online: <<http://www.financialstabilityboard.org/>>. The FSB replaced the smaller and less formal Financial Stability Forum in April 2009 and given more specific missions through its charter by the G-20 in September 2009. Its members include selected central banks, finance ministries and regulators from all Group of Twenty (G-20) states, certain international organizations and two Asia-Pacific financial centres (Hong Kong and Singapore). While the FSB has a clearer mandate and stronger institutional design than its predecessor, it has few resources and its work is contributed mainly by members. The global financial crisis induced changes to the setting for international economic and financial cooperation, including a migration from the G-7 and G-10 mechanisms to a more inclusive and institutionalized G-20. Established after the Asian financial crisis, the G-20 includes major developing and leading developed countries, with China, India, Indonesia, Japan and South Korea as Asian participants. For detailed discussion, see Douglas Arner & Michael Taylor, "The Global Credit Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?" (2009) 32:2 University of New South Wales Law Journal.

<sup>107</sup> *Report from the Finance Ministers of the ASEAN+3 to Heads of States/Governments*. The nature of IMF-led conditionality may alter following the 2007-08 global financial crisis, in particular with the creation of its Flexible Credit Line facilities, which are granted subject to less stringent conditions than traditional IMF standby facilities.

ASEAN or ASEAN+3 financial initiative by being both multilateral in character and substantive in terms of resource requirements.

Even though the realization of CMIM would represent the first truly regional arrangement in monetary cooperation, the consensual manner by which ASEAN+3 proceeds militates against a formal and complex scheme of clear rules, and full independence. The progress of ASEAN+3 in this area might come to be regarded as analogous to the long-term objectives set in the past by the EU and its predecessors.

## **D. Capital Market Development**

Post-Asian crisis attention to regional capital market development initially focused on national debt and money markets but more recently considered wider securities market reform and capital market development and integration. Collaborative debt market development has comprised three efforts: the ASEAN+3 Asian Bond Market Initiative (ABMI), APEC's efforts in developing securitization, and more limited work by members of the Asia Cooperation Dialogue (ACD).<sup>108</sup> It also includes EMEAP central banks' pooling of international reserves in two Asian Bond Funds in 2004 and 2005. 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, both to the detriment of collaborative market reform and in 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 instruments, 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>109</sup> Research teams examined aspects of market development, with one seeking recommendations for securitization and credit enhancement mechanisms to improve the credit risk quality of Asian bonds.<sup>110</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 former 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 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. One working group commissioned in April 2008 a "Group of Experts" from 26 commercial

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<sup>108</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.

<sup>109</sup> See Tenth APEC Finance Ministers' Meeting, Joint Ministerial Statement, (5 September 2003), online: <[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)>.

<sup>110</sup> See Paul Lejot, Douglas Arner & Lotte Schou-Zibell, "Securitisation in East Asia" (2008) Asian Development Bank Working Paper Series on Regional Economic Integration No. 12; Douglas Arner, "Emerging Market Economies and Government Promotion of Securitization" (2002) 12 *Duke J. Comp. & Int. L.* 505.

and public sector organizations to advise on the future of cross-border clearing and settlement, which its principal ADB advisor disarmingly describes as “the first case of effective public and private sector dialogue for the ASEAN+3”.<sup>111</sup> ASEAN and APEC have shown consistent sympathy for schemes to provide credit support for companies or infrastructural projects, and ASEAN+3 said in May 2009 that it would create a US\$500m fund to guarantee local currency debt issues by Asian companies.<sup>112</sup>

The final working group ended prematurely in an example of conflict between national and regional interests. It was charged to explore cross-border local currency bond issuance by states, state and multilateral agencies, and regional companies but the group’s convener allowed it only to examine issuance by multilateral agencies.<sup>113</sup> After encouraging inaugural issues in China and Thailand by the World Bank’s International Finance Corporation (IFC) and the ADB, the group declared its purpose fulfilled and was dissolved, leaving many omissions from its original agenda.<sup>114</sup> Although academically interesting, the contribution of these projects to governance can be argued to date to have constituted a functional specificity that is “so trivial as to remain outside the stream of human expectations and actions vital for integration.”<sup>115</sup>

## 2. Pooled reserves: Asian Bond Funds

The eleven EMEAP central banks are those of ASEAN’s founding members and Australia, China, Hong Kong, Japan, South Korea and New Zealand. The non-Japanese Asian members were the nominal sponsors of collaborative ideas developed in 2003-04 by Hong Kong and Thai officials and implemented as the two Asian Bond Funds (ABF1 and ABF2) as fractional poolings of international reserves. The plan had two roots, in countering criticism of Asia’s massing reserves in non-Asian assets (a development imperative), and a post-crisis belief that active capital markets could provide a stabilizing intermediation resource in times of heightened volatility (the crisis imperative). The project had initial assistance from the Bank for International Settlements (BIS), which was politically important given the absence of usable regional or shared resources, and avoided creating a hierarchy among the participants or the unnecessary creation of a supervening steering organization.<sup>116</sup> Ironically, the commercial managers of the project have been largely of non-Asian domiciles. Both funds were index-based and involved no discretionary management. Their total size at launch was equivalent to less than 0.15 per cent of the subscribers’ aggregate reserves.

The project was innovatory in two respects. Neither fund could directly contribute to market liquidity by encouraging issuance but both departed from traditional reserve management practice by including sub-investment grade EMEAP sovereign securities as investible risks. ABF1 was initially a US\$1.0 billion pooling of core currency Asian bonds held by EMEAP’s Asian members.<sup>117</sup> The subsequent ABF2 was established as a US\$2.0 billion equivalent fund for local currency issues, with families of single currency exchange-

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<sup>111</sup> Satoru Yamadera, presentation to Hong Kong Monetary Authority “Asian Bond Clearing and Settlement” conference, 23 June 2009.

<sup>112</sup> The “Credit Guarantee and Investment Mechanism” to be administered by the ADB, see *Joint Media Statement of the 12<sup>th</sup> ASEAN+3 Finance Ministers Meeting*.

<sup>113</sup> The group was led by officials of China.

<sup>114</sup> Arner, Lejot & Rhee, see *supra* note 44, list many remaining impediments but national restrictions on issuance is the most common.

<sup>115</sup> Haas, “International Integration”, *supra* note 32 at 372.

<sup>116</sup> In addition, it provided the BIS with a concrete initiative to raise its role amongst its regional membership, which includes the EMEAP eleven plus the central bank of India.

<sup>117</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.

traded funds and regional index funds each acquiring and holding sovereign and quasi-sovereign Asian securities.

Hitherto, proposals to create regional financial bodies of any kind were ambitious and not easily implemented,<sup>118</sup> so that a successful ABF2 (the more complex scheme) might have led to structural regional cooperation. The plan's proponents argued that it prompted the creation of Asia's first exchange-traded bond fund, and led two jurisdictions to permit domestic currency exchange-traded funds. Its regional index fund was the first non-bank intermediary to be granted access to China's domestic interbank bond market.<sup>119</sup> ABF2's single currency and regional index funds provided a means to circumvent but not eliminate problems experienced by both offshore and domestic investors in buying certain local currency instruments, including matters relating to custody, enforcement of rights, reliability of transfer and withholding taxes. The plan likely impact however is likely to be most significant in raising awareness amongst financial officials of impediments to such structures and if it encourages the removal of legal and regulatory constraints that made its initial objectives almost impossible to achieve.

The simpler commercial test of the project would be whether it generated liquidity or induced new participants to issue, invest or trade in local currency securities. This aspect of the funds' performance has been poor. In its first six months the sums raised from non-EMEAP sources amounted to only US\$200 million, and subsequently limited outside interest.<sup>120</sup> This project was demanding in seeking 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 was self-limiting as to its external impact on market development, most particularly by establishing index funds that were impossible for commercial investors to replicate or track. Indeed, pre-establishment announcements in 2004 suggested this might be intentional in that ABF2 would "accelerate market and regulatory reform."<sup>121</sup> Unsurprisingly, no such commitments were disclosed, even though they might have encouraged commercial participation. No further developments have been announced since 2005.<sup>122</sup>

### 3. Equity market development and cooperation

Integration of Asia's equity markets is limited, both in the number of foreign listings and in the scale of regional cross-border investment, although this is not unique to Asia. Regional collaboration may improve with the adoption of common minimum standards by domestic securities regulators, probably enhancing certain standards from the International Organization of Securities Commissions (IOSCO). This is an organization of wide membership that coordinates and leads cooperation, benchmarking and information exchange among securities regulators.<sup>123</sup> Its Multilateral Memorandum of Understanding covering

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<sup>118</sup> For example, currency cooperation pacts discussed at intervals by APEC and ASEAN.

<sup>119</sup> Executives' Meeting of East Asia Pacific Central Banks (EMEAP), Press Statement, "The Asian Bond Fund 2 has moved into Implementation Phase" (12 May 2005), online: <<http://www.emeap.org/emeapdb/upload%5CPress%5C12may05.pdf>>.

<sup>120</sup> "Pan Asia fund fails to excite investors", *Financial Times* (13 June 2006).

<sup>121</sup> EMEAP, Press Statement, "EMEAP Central Banks Announce the Launch of the Asian Bond Fund 2", (16 December 2004), online: <<http://www.emeap.org/emeapdb/upload%5CPress%5C16dec04.pdf>>.

<sup>122</sup> EMEAP's 2006 review of the project characterizes the process that initiated the funds as "historic" but describes ABF2 as merely "useful" and lists reasons for its limited commercial appeal, see *Report of the EMEAP Working Group on Financial Markets: Review of the Asian Bond Fund 2 Initiative* (2006), online: <<http://www.emeap.org/>>.

<sup>123</sup> IOSCO has the widest national membership and affiliations of any transnational financial industry body, see <<http://www.iosco.org>>.

interaction among regulators is a template for cooperation, information exchange and enforcement,<sup>124</sup> and it has developed an ever-growing body of principles and standards for securities regulation, including an internationally acceptable offering template for cross-border share issues that incorporates financial statements relying on International Financial Reporting Standards (IFRS).<sup>125</sup> This may begin to influence new issues in Asia and elsewhere, and has so far been seen at its most ambitious in the 2003 EU Prospectus Directive.<sup>126</sup> Asian securities regulators formed an Asia-Pacific regional committee under the IOSCO umbrella in 2007 with support from the ADB,<sup>127</sup> agreeing to use IOSCO standards as a basis for cooperation. ASEAN's Capital Markets Forum (ACMF) agreed regional prospectus standards in 2008 using the IOSCO template for equity and debt securities (the ASEAN and Plus Standards Scheme),<sup>128</sup> with the result first adopted in June 2009 by national exchanges and regulators in Malaysia, Singapore and Thailand.<sup>129</sup> The effect would be to stipulate common cross-jurisdictional standards for disclosure, although issuers hoping to list securities on multiple exchanges would continue to be set other local requirements. Potentially more significantly, building on these earlier initiatives, In April 2009, with the endorsement of the ASEAN Capital Markets Integration Plan<sup>130</sup> at the 13<sup>th</sup> ASEAN Finance Ministers Meeting in April 2009, the ACMF's focus has become broader and more strategic. Focusing on six principles,<sup>131</sup> the implementation plan seeks to achieve the three broad themes of creating an enabling environment for regional integration (including gradual liberalization of capital flows), creating market infrastructure and regionally focused products and intermediaries, and strengthening implementation. The plan thus has a primarily developmental focus, albeit at both the domestic and regional levels, with integration based on eventual mutual recognition on the basis of shared standards and effective infrastructure and regulation.

## E. The Roles of the ADB

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<sup>124</sup> International Organization of Securities Commissions, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (May 2002), online: <[http://www.iosco.org/library/index.cfm?section=mou\\_main](http://www.iosco.org/library/index.cfm?section=mou_main)>. For discussion, see Arner & Taylor, *supra* note 106.

<sup>125</sup> See Douglas Arner, 'Globalization of Financial Markets: An International Passport for Securities Offerings?' (2002) 35 *Int'l Law* 1543; Marc Steinberg & Douglas Arner, *International Securities Law*, 2d ed. (London: Kluwer Law International, forthcoming 2010).

<sup>126</sup> EC, *Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading*, [2003] O.J. L 345/64.

<sup>127</sup> The members of the IOSCO Asia Pacific Regional Committee are Australia, Bangladesh, Brunei, China, Hong Kong, India, Indonesia, Japan, Kyrgyzstan, Malaysia, Mongolia, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, South Korea, Sri Lanka, Taipei, Thailand and Vietnam.

<sup>128</sup> ACMF (October 2008), ASEAN Equity Securities Disclosure Standards and ASEAN Debt Securities Disclosure Standards, online: <<http://www.aseansec.org/acmf/introduction.htm>>. These are based respectively on IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (1998) and International Disclosure Standards for Cross-border Offerings and Listings of Debt Securities by Foreign Issuers (2007).

<sup>129</sup> Securities Commission Malaysia statement, "Malaysia, Singapore and Thailand First to Implement ASEAN and Plus Standards Scheme" (12 June 2009), online: <<http://www.sc.com.my/main.asp?pageid=379&linkid=2212&yearno=200>>. Regulators in Singapore and Thailand made statements to the same effect.

<sup>130</sup> ACMF, *The Implementation Plan* (Apr. 2009).

<sup>131</sup> Specifically: (1) adoption of international standards to the maximum extent possible; (2) progressive liberalization; (3) sequencing; (4) coordination; (5) consistent implementation, with effective monitoring; and (6) communication and consultation to set priorities and build consensus.

The ADB mixes regional interests and elements of regional governance but historically has lacked autonomy in its regional policy orientation. While its mandate and operations focus on regional development, 18 of the Bank's 65 shareholders are non-Asian OECD members that together account for 34.75 per cent of votes in the bank's supervisory Board of Governors. G-7 members hold 39.9 per cent 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, ADB regional policy interests may not coincide with the aims of all shareholders, and only recently has an increase in their capital commitments been agreed among ADB shareholders, more than a decade after being first proposed within the region.<sup>132</sup> This adjustment was encouraged by certain Asian states garnering strategic leverage from the global financial crisis, similar to the G-20 supplanting the G-7 and other traditional groups of states in 2009. Asian policymakers may once have supported ADB efforts because of the weak institutional basis of ASEAN, APEC and similar bodies, but may now acquire a stronger influence in a more robust ADB with a mandate to increasingly pursue regional economic integration and providing related support and resources.

The ADB has given material operational support to financial sector cooperation. 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>133</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 that its Asian bonds web portal will widen the availability of market information to potential users.<sup>134</sup>

More significantly, OREI was established in 2005 to promote economic cooperation and integration among the bank's developing members and contribute to the region's "harmonious economic growth".<sup>135</sup> This was part of the agenda of ADB president Kuroda to emphasize regional and financial integration, and provide resources for related research and technical assistance projects and investment. A successful OREI may ameliorate the ADB's lack of coherent objectives when compared to the World Bank, which has maintained a focus on domestic market development. An ADB Eminent Persons Group published a favourable assessment of these reforms and the potential value of OREI<sup>136</sup> and in 2008, ADB members

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<sup>132</sup> See ADB, "General Capital Increase V", online: <<http://www.adb.org/GCI/default.asp>>. In early 2009, US and other non-Asian interests withdrew their veto of additional capital, maintained since the late-1990s due to differences over ADB strategy and governance, and shareholders agreed a 200 per cent increase in capital committed to the ADB to US\$165 billion, see ADB press notice "ADB Triples Capital [...]" (30 April 2009), online: <<http://www.adb.org/Media/printer.asp?articleID=12869>>. This will allow overall outstanding ADB lending to increase by around 45 per cent by end-2010, including support for post-crisis deficit funding through a new US\$3 billion Countercyclical Support Facility (soon committed in July 2009 to Indonesia, Philippines, Vietnam and Central and South Asian states) and approximately US\$7 billion in funding for infrastructural projects, see ADB, "The Global Economic Crisis Challenges for Developing Asia and ADB's Response" (April 2009) at 18-23, and *idem.*, "ADB's Response to the Global Economic Crisis: an update (August 2009) at 13, online <<http://www.adb.org/Economic-Crisis/default.asp>>.

<sup>133</sup> Khempheng Pholsena, ADB Vice President (Finance and Administration), "Opening Remarks at the Asian Bond Markets Initiatives" (Address to Seminar on Local Currency Bond Issuance by Foreign Multinational Corporations, Shanghai, 5 August 2004), online: <<http://www.asiandevbank.org/Documents/Speeches/2004/ms2004049.asp>>.

<sup>134</sup> See <<http://asianbondsonline.adb.org>>.

<sup>135</sup> Haruhiko Kuroda, ADB President, "Opening Remarks" (Address at the Governors' Seminar on a Roadmap for Asia's Economic Cooperation and Integration, ADB 2005 Annual Meeting, Istanbul, 3 May 2005), online: <<http://www.adb.org/AnnualMeeting/2005/Speeches/president-kuroda-speech-roadmap.html>>. OREI was created in April 2005.

<sup>136</sup> Eminent Persons Group, *Towards a New Asian Development Bank in a New Asia: Report of the Eminent Persons Group to the President of the Asian Development Bank*, (Manila: Asian Development Bank, 2007). The

explicitly committed the organization to regional integration as one of its three guiding developmental agendas,<sup>137</sup> reinforcing not only the role of OREI but also of regional initiatives across ADB's operations.

## V. Conclusion: Looking Forward

Europe's protracted experience of forming a single regional financial market indicates the scale of obstacles to Asian financial integration, which at best is only at a stage similar to the first European efforts. Policy attention given since the mid-1990s to Asian market development has led to two tangible results. The first, a bilateral credit line construct (CMI), is modest in scale and widely discounted as symbolic but may become in CMIM a more notable arrangement. The second, the two ABFs, is constrained from directly affecting liquidity or supporting development meaningfully. Two questions then arise as to prospects for further regional integration. First, does CMIM represent a material qualitative change that may lead to the creation of true regional institutions; and second, will regional integration be hastened by Asia's increased strategic and economic leverage in a post-crisis world?

While CMI's profile has little relation to its modest impact in form and scale, its successor may become an institution to support a currency alignment area, for example, through a currency pact similar to those adopted in Europe in the 1970s (the "snake") or the managed currency convergence that preceded the creation of the single currency. Even with no common Asian currency policy, CMIM may be a foundation for a regional monetary fund with responsibility for external and macroeconomic surveillance and the provision of regional liquidity support. Historians of Europe's experience show how it contemplated creating a single currency long before this became planned or feasible.<sup>138</sup> Asia's wish to avoid exchange rate volatility to protect its export performance and the value of overseas investments is of similar long standing.

If regionalism is taken to be the results of a large scale conception, for example:

[f]rom 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>139</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>140</sup>

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group comprised Supachai Panitchpakdi, Isher Judge Ahluwala, Nobuyuki Idei, Caio Koch-Weser, Justin Yifu Lin and Lawrence Summers.

<sup>137</sup> ADB, *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008-2020* (Apr. 2008).

<sup>138</sup> Barry Eichengreen, "Fostering Monetary & Exchange Rate Cooperation in East Asia" in Duck-koo Chung & Barry Eichengreen, eds., *Fostering Monetary & Financial Cooperation in East Asia* (Singapore, World Scientific Publishing, 2009) at 11.

<sup>139</sup> Nicola Philips, "Governance after Financial Crisis: South American Perspectives on the Reformulation of Regionalism" (2000) 5:3 *New Polit. Economy* 386.

<sup>140</sup> *Ibid.*

Even if the transnational model of regionalism has no application in Asia due to entrenched consensuality and national interests, the more practical functionalism implicit in the second alternative is a limited objective in financial integration that ASEAN+3 members may be willing to accept, especially in a period of global re-regulation.<sup>141</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>142</sup>

As such, elements of the second stage of European financial regionalization may assist the process of Asian financial cooperation and development, notably in shared commitments to reform, progressive voluntary harmonization to common minimum standards, and eventual liberalization and mutual recognition through more formal regional arrangements, marking the transformation of ASEAN or ASEAN+3 to integrated bodies from mere “regional clubs” of states.<sup>143</sup> Clearly, the recently adopted ASEAN capital markets integration plan reflects this approach in the context of securities. Initiatives adopted within ASEAN+3 and EMEAP may increase accountability, transparency and the extent of participation in reform in ways that become generally beneficial to economic development as well as supporting greater trade and economic integration, which could enhance intra- and extra-regional balance. This is conceptually similar to ASEAN’s existing approach and accords with the ADB’s identification of accountability, predictability, participation and transparency as principles of essential financial governance.<sup>144</sup>

## **A. Assessing East Asian Financial Integration**

Cooperation in financial policy among Asia’s economies has limited history and results, even though Asia’s need for market reforms is associated with substantial tasks in national and multilateral policymaking, and might have been profoundly advanced 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>145</sup> leading to doubts as to the effective influence in financial policy formation of

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<sup>141</sup> See Amitav Acharya, “How Ideas Spread: Whose Norms Matter? Norm Localization and Institutional Change in Asian Regionalism” (2004) 58 *Int. Org.* 239 (using a similar argument in the context of cooperative regional security).

<sup>142</sup> Cally Jordan & Giovanni Majnoni, “Financial Regulatory Harmonization and the Globalization of Finance” (2002) World Bank Policy Research Working Paper No. 2919, at 9. 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.” *Ibid.* at 9-10.

<sup>143</sup> Vincent Cable, *Globalization and Global Governance* (London: Royal Institute of International Affairs, 1999) at 54-62, noting that the reliance of state clubs upon reciprocity militates against strong governance, *ibid.* at 61. Regional leadership issues are beyond the scope of this paper but several configurations could allow integration to advance even if ASEAN is unwilling to accept leadership by China nor China by Japan, including regional leadership that is formally shared, divided, cooperative, coalitional or goal-centred, see Christopher Dent, “What Region to Lead? Developments in East Asian Regionalism and Questions of Regional Leadership”, in Christopher Dent, ed., *China, Japan and Regional Leadership in East Asia* (Cheltenham, Edward Elgar, 2008), at 23-24.

<sup>144</sup> Asian Development Bank, *Improving Governance and Fighting Corruption: Implementing the Governance and Anticorruption Policies of the Asian Development Bank* (Manila: Asian Development Bank, 2006).

<sup>145</sup> See e.g., James Baker, *The Politics of Diplomacy: Revolution, War, and Peace, 1989-1992*, (New York: G.P. Putnam’s Sons, 1995), at 609-11. The former US Secretary of State notes his determination while in office that

Asia's multiplicity of regional bodies.<sup>146</sup> To the extent that certain material results exist, their main value may rest in the fact of completion. At the same time, there have been long-standing examples of the independent adoption by national authorities of like external financial policies, most clearly seen in currency management in the five years prior to 1997 and reserve accumulation since 2000.

Asia's economic and financial integration has lacked an institutional and legal framework set within the region. In contrast to the rule-focused WTO or EU, 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 are most evident in the context of exchange rate arrangements, suggesting that they will remain problematic for some time, not least because no Asian national economy has relinquished its export orientation since the model was adopted in the 1950s by Japan, given that recent fiscal expansion measures will be temporary. The most constructive policy result in the current recession may therefore be a more cooperative approach to the use of international reserves and regional investment.

Second, since Asia's prevailing regional organizations and institutions are weak or constrained by state-orientated governance, the outcome for 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. Despite its contribution to economic integration the commercial sector has been formally included in Asian financial integration only recently, and in contrast with the EU pattern given no transparent role in governance. Financial integration may require "multi-level governance" that involves many actors, rather than Asia's state-centric tradition.<sup>147</sup> Regional efforts in regulatory cooperation and harmonization to common regional standards based upon international standards may be among the most promising roads to greater integration, financial stability and development. This approach could be influenced by EU legal instruments, and reflects experience with international financial standards and technocratic cooperation. In this context, the initial meetings of the Asian Financial Stability Dialogue are a significant development.

Finally, it may become possible through formal commitments and a revised AFAS to liberalize the regional financial service sector gradually without destabilising effects. This would result from state initiatives, and would follow global remedial and re-regulatory responses to the 2007-08 crisis. The process would rely on shared interests and a progressive harmonization to regionally agreed prudential practices and market standards derived from

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"any move towards economic integration in East Asia include the United States," such that notably in 1991 he did his "best to kill" an East Asian Economic Group then proposed among APEC's East Asian members.

<sup>146</sup> Sceptics include Nick Bisley, "The End of East Asian Regionalism?" (2003) 17:1 J. East Asian Aff. 148; John Ravenhill, "APEC Adrift: Implications for Economic Regionalism in Asia and the Pacific" (2000) 13:2 Pac. Rev. 319. 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", (Paper presented to the Conference on Asia-Pacific Economies: Multilateral vs. Bilateral Relationships, City University of Hong Kong, 21 May 2004); Susumu Yamakage, "The Construction of an East Asian Order and the Limitations of the ASEAN Model" (2005) 12:2 Asia-Pac. Rev. 1, suggesting that Asia's regional model body may inherently conflict with collective policy initiatives.

<sup>147</sup> Most of Asia's financial development initiatives to date have been introduced by delegated authorities such as central banks and financial regulatory agencies, but without sustained input from the clients that they respectively regulate.

international best practices, as contemplated in the context of ASEAN capital market integration. Any such liberalization would begin with domestic governance requirements and continue through a process of mutual recognition. China's actions may be influential in this respect, especially if its example encourages other states to make liberalization commitments similar to those negotiated in its WTO accession. This approach would be most valuable if China first focused on regional liberalization.<sup>148</sup> Cooperation of this kind might allow ASEAN+3 members to take a more proactive stance in the stalled GATS financial services negotiations and in international standard setting bodies coordinated through the newly reconstituted FSB, especially if China's form of managed capitalism is more widely favoured after the current crisis. At the same time, in the context of cross-border establishment of financial institutions, the EU's experience in the context of the global financial crisis is instructive: in Asia there is little interest in regional regulatory authorities and as a result, while cross-border establishment may be liberalized as domestic regulation becomes increasingly developed to regional standards, the branch-based model should not be pursued but instead should be based on the premise of separately regulated jurisdictional subsidiaries,<sup>149</sup> albeit regulated to harmonized regional norms derived from Asian influenced international standards.

Adjustments of this type 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 isolated examples of instability that quickly became contagious, and the problem has been avoided recently due only to the global credit crisis being less intense in Asia than elsewhere. Unless Asia devotes resources in governance to improve regional financial integration and support domestic legal and regulatory reform, development will rely on a continuing export orientation, to the detriment of general welfare, financial development and economic stability. Reserve accumulation and risk averse national portfolio management may cease to be acceptable dominant policy options in a less globalized world.

## **B. Implications of the Global Financial Crisis for East Asian Financial Integration**

Asia's post-1998 recovery model differed little from that of Japan in the 1950s, later adopted by South Korea in the 1960s, other newly industrialized economies in the 1970s and China after 1978, namely, an export orientation with financial intermediation considered secondarily.<sup>150</sup> East Asia experienced steep falls in exports and output in 2008, but its financial systems have been less broadly affected than those of many developed countries in Europe or North America. Certain Asian banks and other intermediaries suffered material losses in a similar fashion as their western counterparts but most credit and capital losses in the Asian financial sector arose where financial intermediaries were sold complex instruments by firms domiciled outside the region. Although credit defaults and loan delinquencies are certain to rise in the recovery from recession, non-cyclical losses among Asian banks and dealers have not primarily been Asia's cause.

This propitious outcome may also reflect caution among Asian governments towards financial sector liberalization that followed the loss of confidence in the region in 1997-98, and a general lack of financial innovation among the region's financial intermediaries

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<sup>148</sup> It should be noted that a state that is open to financial service sector entry may not signify a state willing to permit domestic or foreign participants to engage freely in commercial activities.

<sup>149</sup> For discussion, see Douglas Arner & Joseph Norton, "Building a Framework to Address Failure of Complex Global Financial Institutions" (2009) 39 Hong Kong Law Journal 95.

<sup>150</sup> For detailed discussion, see Qiao Liu, Paul Lejot & Douglas Arner, *Finance in Asia: Institutions, Markets and Regulation* (Oxford: Routledge, forthcoming 2010).

compared to the intense leveraging of capital, liquidity and structured credit risk by large intermediaries in New York and London.<sup>151</sup> Innovation and financial integration in Asia were impeded after 1999 by supervening state concerns as to national sovereignty and currency policy. This resistance was intensified by reflection on the Asian crisis, with states acutely nervous of capital inflows, sharing the view that IMF policies in 1997-99 were hostile, unnecessarily damaging to output and domestically destabilising. Asian states felt themselves ignored by and represented inadequately within the IMF.

Asia's significant global creditor position and the less severe impact that it suffered compared to other regions in the 2007-09 crisis led to an accrual of strategic influence, especially for China, Japan and South Korea, and altered the balance of regional authority between China and Japan. This contributed to certain practical reforms in 2009, both globally and within the region. In the first instance, the G-20 committed itself to:

a shift in [IMF] quota share to dynamic emerging markets and developing countries of at least 5% from over-represented countries to underrepresented countries using the current quota formula as the basis to work from.<sup>152</sup>

The G-20 acknowledged that quota changes will ultimately alter IMF decision making, for example in the formulation of subsequent quota adjustments and drawing entitlements, and in the composition of its executive board.<sup>153</sup> Second, China forcefully questioned the US dollar's sole reserve currency status, suggesting that reform might be included in a functional review of the IMF and the global financial architecture.<sup>154</sup> Finally, the same enhanced authority was used in a regional context in two instances in response to the global financial crisis, with the establishment of CMIM and the ADB's increase in capital.

Whether the global crisis continues to spur integration in the region is not straightforward. First, financial sector re-regulation may discourage transnational uses of risk capital and thus obstruct integration at least until confidence is generally restored, even among well-integrated EU financial markets. Second, Asia's greater prominence in a modified global system might lessen its incentive to introduce separate regional measures such as a discrete AMF. Alternatively, pressure for financial integration may increase within ASEAN, a group without the leverage to be afforded by the G-20 to China and Japan and to a lesser extent to Indonesia and South Korea.

It is certainly possible that constraints to Asian financial integration may be eased as a result of policy responses to the 2007-09 financial crisis, with results that contrast with the gradualist practices described throughout this paper. A similar reaction is less likely to measures decided by the G-20 in April and September 2009 to sanction IMF facilities subject to less stringent conditions for use than traditional standby lines, despite their being welcomed in the region.<sup>155</sup>

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<sup>151</sup> See Douglas Arner, Paul Lejot & Lotte Schou-Zibell, "The Global Credit Crisis and Securitisation in East Asia" (2008) 3:3 Capital Markets Law Journal 291.

<sup>152</sup> G-20 Leaders' Statement: The Pittsburgh Summit, 25 September 2009, online: <<http://www.pittsburghsummit.gov/mediacenter/129639.htm>>, Preamble at s. 21.

<sup>153</sup> *Ibid.*, at s. 21.

<sup>154</sup> Zhou Xiaochuan, Governor, People's Bank of China, speech "Reform the International Monetary System", 23 March 2009, online: <<http://www.pbc.gov.cn/english/detail.asp?col=6500&ID=178>>, calling for the creation of a "super-sovereign reserve currency" with greater prominence for a reconstituted SDR to include emerging currencies.

<sup>155</sup> The IMF introduced its Flexible Credit Line in March 2009 as one of several reforms to ease lending conditionality and to which East Asia had become hostile, see IMF, "IMF implements major lending policy improvements", 24 March 2009, online: <<http://www.imf.org/external/np/pdr/fac/2009/032409.htm>>.

### C. An Asian Monetary Fund

The attractions of an AMF have returned to discussions among states in the region. This paper concludes by outlining the functions that such an organization might perform and its likelihood of coming into being.

In the long-term, two functions might come to be associated with CMIM, those related to its founding purpose of an interdependently operating liquidity facility and others for which CMIM would be an institutional first step. The latter could include facilities for medium-term infrastructure funding, external budget assistance, and surveillance and operations to assist the formation and management of a currency alignment area comprising all or certain ASEAN+3 members. Currency cooperation is beyond the plans of ASEAN+3 to date, but equally falls well short of a template for a less feasible joint or federal central bank or a single regional currency.<sup>156</sup> Strong advocates of an AMF see CMIM as the first tangible step to its creation, so for example when under CMIM:

an effective regional surveillance mechanism is fully in place, and the surveillance unit exhibits its ability to formulate independent conditionality associated with crisis lending, the multilateral CMI can be delinked from IMF programs, paving the way toward the creation of an Asian Monetary Fund. An AMF is essential to support Asia's rebalancing process, as economies in the region would accept smaller current account surpluses—and less accumulation of foreign exchange reserves—if an AMF would mitigate financial turbulence and act as a regional lender of last resort.<sup>157</sup>

This reflects an official Japanese view of long-standing.<sup>158</sup>

Even without reforms to the regional financial architecture, ASEAN+3 finance ministers and EMEAP would continue to address macroeconomic cooperation and coordination, while regulatory organizations (EMEAP, ABMI, ACMF and regional sub-groups of organizations such as IOSCO) will address standard setting for financial stability concerns but not macroeconomic monitoring. Crisis resolution at sovereign level remains with the IMF with support from ADB and the World Bank, as during the Asian financial

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<sup>156</sup> A single currency requires user states to share sovereignty, and is arguably blocked by the terms of the current ASEAN Charter, art. 2 s.2(a). However, a formal alignment of currencies among self-selecting states would entail independent tests for admission and ongoing macroeconomic surveillance of the kind projected by ASEAN+3 for CMIM, regardless of the mechanics of alignment (which include a common currency similar to the former European currency unit, or exchange regimes involving fixed or adjusting links to single currencies or indexes).

<sup>157</sup> Masahiro Kawai, Dean, Asian Development Bank Institute, "Global Financial Crisis and Japan-ASEAN Economic Cooperation" (speech to Japan-ASEAN Dialogue, 11 September 2009), online: <<http://www.adbi.org/speeches/2009/09/15/3326.kawai.gfc.8th.japan.asean.dialogue/>> at 5. The speaker suggests that a credible CMIM surveillance mechanism would allow Japan to provide an alternative source of liquidity from the United States for stressed ASEAN states, *ibid.* This would be a reversal from *ad hoc* credit practices under CMI.

<sup>158</sup> Former Japan finance vice-minister Eusike Sakikabara, a vocal proponent of AMF in 1997-98, told an ADB conference in May 2009 that earlier proposals were vetoed:

because of a strong opposition from the United States, as well as a lack of consultation by the Japanese government with its Asian neighbours – especially [China]. But now the situation has evolved and Asia is in a stronger position to create an AMF.

crisis. As is the case generally, no transnational arrangements exist to deal with resolution of individual financial intermediaries,<sup>159</sup> nor (outside of the EU) with the contagion impact of rapid losses of confidence that affect several or all states in a region.

In general, global or regional financial cooperation mechanisms have six common elements: (1) macroeconomic policy cooperation and coordination; (2) macroeconomic standard-setting and surveillance; (3) financial stability standard-setting and monitoring; (4) facilitation of liberalization and dispute resolution; (5) liquidity provision; and (6) crisis resolution at the macro (state) or micro (financial intermediary) level.<sup>160</sup> Under this framework, CMIM would embrace macroeconomic policy standard setting and performance surveillance, and operations involving emergency external liquidity.

If CMIM were to evolve into an AMF, it would seem logical to combine liquidity provision and economic policy standard-setting and monitoring with more formal arrangements for developing and monitoring regional financial regulatory standards based on the experiences of the FSB and the EU, using firmer arrangements than those of the former but less extensive than those in Europe. One model is IOSCO's Multilateral Memorandum of Understanding, with a self-regulatory structure applying to standard-setting and monitoring, together with support from the ADB.

This highlights the important link between macroeconomic and financial stability standard-setting and surveillance in the operation of the liquidity mechanisms of an AMF. The division between liquidity issues and sovereign financial crises is not always clear. Both this issue and the supporting mechanisms merit the greatest design attention. As this paper has shown, if CMIM is to be introduced according to customary practice, it will require dedicated resources to be effective and generate confidence.

The independence of surveillance conducted by CMIM or a future AMF will be critical not only to the organization's reputational standing and whether it becomes a credible force, for the lack of use of CMI lines is believed to stem from the unwillingness of all members to allow drawings. CMIM or an AMF will need to conduct operations reliably and without favour. Institutional developments of this kind provide an opportunity to consider the proper organization of the functions outlined here, whether or not formalized into a new AMF. However, CMIM's operational outcome will not be immediately clear and Asia may well continue with its equivocal approach to financial regionalism.

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<sup>159</sup> National and cross-border arrangements to address financial intermediary failure are current concerns of the G-20 and the subject of ongoing discussions within the Basel Committee on Banking Supervision.

<sup>160</sup> See generally Douglas Arner & Ross Buckley, "Reforming the International Financial Architecture", (2009) AIIFL Working Paper No. 7 [forthcoming], online: <<http://www.aiifl.com>>.