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## Financial and Monetary Cooperation in ASEAN

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Philippine Institute for Development Studies  
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## Financial and Monetary Cooperation in ASEAN

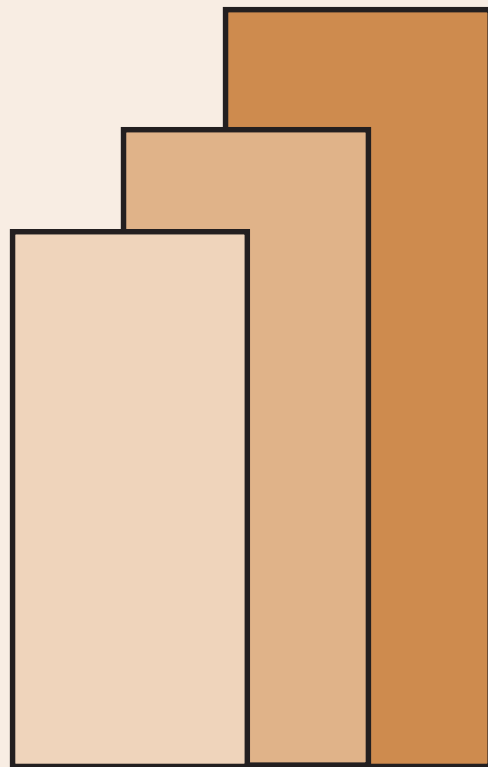
*Mario B. Lamberte and Josef T. Yap*

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## **Abstract**

One result of the 1997 East Asian financial crisis was greater awareness of the need for closer financial and monetary cooperation. This paper makes an inventory of the institutional developments in this area in East Asia, with emphasis on Southeast Asia. The major issues that must resolve include: (i) whether the participation should be limited to ASEAN or expanded to include the whole East Asia region; (ii) the sequencing of activities; and (iii) the institutions that must be consolidated or established to carry out these activities. Since financial and monetary integration remain a distant goal, efforts must focus on monetary and financial cooperation—particularly the latter, mainly in terms of harmonization of standards—that will facilitate greater trade and investment integration and enhance financial stability in the region.

Keywords: regional integration, monetary and financial cooperation

## Financial and Monetary Cooperation in ASEAN

*Mario B. Lamberte and Josef T. Yap<sup>1</sup>*

### I. Introduction

Prior to the Asian financial crisis in 1997, the larger countries in Southeast Asia—Malaysia, Thailand, Indonesia and to a certain extent the Philippines—had been referred to as the Southeast Asian Newly Industrialized Economies (NIEs) in recognition of their achievements that were comparable to the economic growth trajectory of Singapore, Taipei, China and Korea. The region was the new hub of global investment, its importance underlined by a potential market of more than 500 million people, with a combined GNP of \$533 billion (2000) roughly equal to that of South Asia, which has a population three times as large.

The economic progress was due in no small measure to the greater integration of the NIEs into the global economy. More outward oriented trade regimes spurred export-led industrialization. Meanwhile, capital flows—primarily in the form of foreign direct investment—provided another rationale for the shift to export-oriented activity as the Southeast Asian NIEs were the primary beneficiaries of greater FDI inflows from Japan, which was in the process of restructuring its economy. However, it was only in 1992 that more concrete steps were taken by ASEAN to enhance regional integration in the form of a Regional Trading Arrangement (RTA).

Even if the benefits from the ASEAN Free Trade Area (AFTA) have yet to be ascertained, the goal of establishing ASEAN Economic Community by 2020 has already been set. The areas to be covered are: trade in goods; investment; trade in financial and other services; infrastructure; customs; standards, mutual recognition agreements and conformity assessment; small and medium enterprises; e-ASEAN; and intellectual property. The progress and expected benefits of ASEAN regional integration are discussed in the next section.

The flip side of regional economic integration is regional cooperation. While there are many dimensions to regional cooperation, this paper focuses on financial and monetary cooperation. Interest in this topic was built up by the 1997 East Asian financial crisis. There is now a consensus that greater intra-regional trade and investment requires financial stability. Needless to say, financial instability can slowdown the pace of economic integration in the region. The economic damage caused by the contagious financial crisis has clearly made this point. Recent work in the area of regional integration and cooperation is succinctly presented in a two-volume publication by the Asian Development Bank (2003). However, it should be noted that the ADB study deals not only with ASEAN but with the entire East Asia region.

Regional cooperation in the monetary and financial spheres can be justified by three phenomena that were highlighted during the 1997 crisis (Montiel, 2003): (i) spillovers from exchange rate policies, which presents a reason for exchange rate coordination; (ii) inadequate supplies of international liquidity; and (iii) common structural weaknesses in the

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financial sector and corporate governance, which can be addressed more effectively by cross-country cooperation in the reform process. The European experience is also cited as factor that has heightened interest in greater financial and monetary cooperation. Similar arguments along with a useful review of the theoretical literature on the potential benefits of monetary policy coordination were discussed in a working paper published by the Forum on East Asia Monetary Cooperation (Ryou and Wang, 2003).

The ADB study conveniently divides Monetary and Financial cooperation into two areas: (i) cooperation in macroeconomic policies and (ii) financial sector reform and development. International coordination in financial sector reform—including corporate governance issues—can be further rationalized based on two observations.<sup>2</sup> First, the spillovers associated with financial crises suggest that financial stability is a public good in which individual countries, because they ignore the effects on neighbors, would tend to underinvest. Second, since capital is likely to flow to countries where financial regulation is more lax, international coordination is also justified by the need to avoid a “race to the bottom” in financial regulation.

This paper delves into the institutional aspects of these issues—particularly with regard to financial sector reform—by addressing the following three questions:

1. What policy and institutional structures at the regional level help support financial change and development in East Asia in general and ASEAN in particular?
2. How do these institutions and arrangements interact?
3. How should they be evaluated?

Before answering these questions, a brief overview on the state of ASEAN regional integration is given. This is the topic of the next section. Answers to the aforementioned questions are then discussed in sections III, IV, and V. The last section makes some concluding remarks.

## **II. Progress in Regional Economic Integration in ASEAN**

Economic integration in the selected areas (trade in goods, investment, etc.) is expected be beneficial by creating a single market much larger than any of the individual nations within the 10 members of ASEAN. Market integration should promote intra-ASEAN trade and allow for economies of scale for production. It should also encourage domestic and intra-ASEAN investment and at the same time attract more foreign direct investment into the region. Meanwhile, ASEAN economic integration is also expected to contribute to the convergence—i.e. narrowing of economic disparities—among member countries.

Regional economic integration generally proceeds in a hierarchical fashion. The most basic form is a free trade area of which AFTA is an example. This is followed by a customs union, a common market, an economic union—of which the EU is the only example—and full political union—of which the US is an example. The process of economic integration generally proceeds along two dimensions: trade and finance. At one end of the spectrum economic integration deals solely with trade liberalization and towards the other end, regional

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<sup>2</sup> Quoted from Montiel (2003) who in turn cited a 2001 article of Barry Eichengreen entitled “Hanging Together? On Monetary and Financial Cooperation in Asia.”

monetary cooperation becomes an important issue. At present ASEAN—in tandem with China, Korea, and Japan—is laying the groundwork for greater regional monetary cooperation although a full monetary union remains a distant goal (Fabella, 2002; Montiel, 2003).

There are a number of studies that show that trade liberalization and openness to trade increases the growth rate of income and output. A country's trade policy is the key link in the transmission of price signals from the world market to the national economy. Undistorted price signals from world markets, in combination with an appropriate exchange rate, allow resource allocation consistent with comparative advantage, thereby increasing productivity. However, from an efficiency standpoint, the ASEAN RTA is likely to hurt member countries (Hoekman et al., 2000). The reason is that in RTAs between developing countries, the trade preferences typically displace efficiently produced low-priced imports from non-partner countries (usually industrialized countries) with inefficiently produced high-priced products from partner countries. A solution to this problem is for member countries to lower their external trade barriers, thereby reducing the inefficient displacement of non-partner country imports.

Financial integration is also seen to be beneficial to economic growth. Conventional wisdom points to the role of financial deepening in accelerating economic growth. Meanwhile, greater financial integration promotes domestic financial deepening and also permits portfolio diversification, which allows higher profitability of investment (De Gregorio, 1998). By transitivity, greater financial integration is conducive to higher economic growth. However, a recent study that used a calibrated neoclassical model has shown that the gains of a typical developing country from greater financial integration are quite limited (Gourinchas and Jeanne, 2003). The gains are negligible compared to the potential benefits of catch-up in domestic productivity. A crucial implication is that the risks that accompany greater financial integration, e.g. possible contagion effects, may not be worth the limited welfare gains.

These considerations serve as a reminder as to the reasons ASEAN members were reluctant to proceed with regional economic integration (Chia, 2000). One, the wide differences in levels of economic development, industrial competence and commitment to free trade made it difficult to forge consensus on economic integration. Two, there was—and most likely this condition is still relevant—limited complementarity, except between Singapore and the other ASEAN countries. At present, limited complementarity may exist between the Southeast Asian NIEs and the CMLV countries. And three, ASEAN was—and remains—too small to be economically crucial for individual member countries. Intra-ASEAN trade is still relatively small and sources of investment are largely extra-ASEAN. These reasons are also important in determining whether ASEAN is a viable area for regional integration or, as argued in **Section V**, whether the scope should be widened to encompass the whole of East Asia.

Data in **Table 1** show that as a percentage of total exports in the region, intra-ASEAN exports stood at 25.2 percent in 1996. After the crisis, the level fell slightly before recovering in 2000. In 1980 and 1988, intra-regional trade for the Southeast Asian NIEs and Singapore was 16.7 percent and 17.7 percent, respectively. These data show that intra-regional trade in ASEAN is relatively small, especially when compared to the EU where intra-regional trade stood at 61 percent in 2000. Another observation is that even if left to market forces, intra-regional trade in ASEAN has prospered, albeit at a slow pace. Meanwhile, the impact of the 1997 crisis, while noticeable, is not that large.

The 1997 financial crisis had a more pronounced impact on intra-ASEAN foreign direct investment (**Table 2**). As a ratio of total FDI, intra-ASEAN FDI fell from 20 percent in 1997 to only 9.4 percent in 2000. The comparable figure for the EU is 68 percent in 1999. The data, in general, support the need for greater financial stability which, in turn, can be achieved partly through greater financial and monetary cooperation.

### **III. Policy and Institutional Structures**

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

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

Japan's idea of creating an Asian Monetary Fund in the wake of the East Asian financial crisis did not take off the ground due to strong objections from the US and IMF and lack of support from China, the largest economy in the region. In November 1997, the deputy finance ministers and central bank governors from 14 countries in East Asia and the Pacific met in Manila, and at the conclusion of said meeting issued “A New Framework for Enhanced Asian Regional Cooperation to Promote Financial Stability.” This framework includes 4 initiatives: (1) a mechanism for regional surveillance to complement global

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

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

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

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



The **South East Asia, New Zealand and Australia (SEANZA)** is the oldest organization, which originally was formed outside of East Asia<sup>3</sup> and later on included most of the East Asian countries. It has currently 20 member economies. Central bank governors who represent their respective countries meet annually. It promotes cooperation among central banks in the region by conducting intensive, biennial central bank training courses (Fraser 1995). Its specific objectives are: to assist in the development and training of senior officers for higher central banking executive positions; to build up knowledge of central banking, with particular reference to conditions the in SEANZA countries; to promote understanding of developing countries; and to foster friendly relations and technical cooperation among central banks in the SEANZA region. The hosting of training courses is rotated among member countries.

The **South East Asian Central Banks (SEACEN)** was organized in 1966 to provide a forum for SEACEN central bank governors for exchanging information and ideas to enable the governors to be familiar with each other and to gain deeper understanding of the economic conditions of the individual SEACEN countries. It is currently composed of 12 countries in Asia. In 1972, it set up a training and research centre located in Kuala Lumpur. The SEACEN Centre became a separate legal entity in 1982. The Centre's objectives are: to promote a better understanding of the financial, monetary, banking and economic development matters which are of interest to the central banks and monetary authorities of the countries in South East Asia or of interest to the region as a whole; and to stimulate and facilitate cooperation among central banks and monetary authorities in the area of research and training. These objectives are carried out through its research and training activities as well as through its advisory and technical services.

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

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

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<sup>3</sup> The original members are Australia, India, New Zealand, Pakistan and Sri Lanka).

financial reforms, integration and cooperation in the region, and to develop the desired vision of regional financial and monetary cooperation.

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

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

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

#### **IV. Interactions Among Institutions**

The main objective of the regional institutions and arrangements described above is to foster closer financial cooperation in the region. They interact among each other through two levels. One is through membership and the other, through their programs or initiatives aimed at achieving closer financial cooperation in the region.

##### **A. Membership**

The various regional institutions and arrangements have overlapping membership with core members including most, if not all, of the ASEAN member countries (**Table 3**). Overlapping membership in these institutions has some advantages. First, the core members can help steer the direction of the programs of the various institutions in a more coordinated manner. Second, members can allocate the programs to those that have a decided advantage to carry them out. Duplication of programs can therefore be minimized. Third, duplication of activities can occur but the presence of noncore members can bring in fresh resources or different perspective to the same issues. However, there are disadvantages. One is that members may have financial, human and time constraints to attend to all the activities of the various institutions. These can slowdown program formulation and implementation of the various institutions. Another is that non-core members may bring in activities or issues to the institutions that are tangential to the interest of the core members.

##### **B. Functions**

In determining interactions of the various institutions at the program level, we have identified four core functions of the institutions that help support financial development and

cooperation in the region.<sup>4</sup> These are: (i) strengthening domestic institutions and markets; (ii) developing regional arrangements and markets, which includes regional financial and capital markets, regional financial arrangements and monetary policy and exchange rate systems; (iii) capacity building; and (iv) research. The first function corresponds to the ADB category of financial sector reform and development while the second core function covers macroeconomic cooperation. The results are summarized in **Table 4** and discussed below.

### Strengthening of domestic institutions and markets

Earlier it was mentioned that financial sector reform may require intra-regional cooperation. However, strong domestic institutions and markets can also be a foundation for developing regional financial cooperative arrangement. The recent region-wide financial crisis has shown how weak these institutions and markets are in most East Asian countries despite decades of high economic growth rates. Poor corporate governance of nonfinancial firms can easily spill over into the banking sector. As shown by Klapper and Love (2002), firm-level corporate governance and index and country-level legal indicators are low for most countries in the region (**Table 5**). Five years after the crisis, most banks in the region have still weak balance sheets, which have constrained their ability to intermediate funds. The corporate bond market hardly exists in most countries in the region due to policy, regulatory and legal constraints.<sup>5</sup> Moreover, the quality of the financial infrastructure to support the development of the corporate bond market has been found to be generally poor in most East Asian countries (**Table 6**).

Since the crisis, most regional institutions have placed greater emphasis on the need to strengthen domestic institutions and markets to restore investor confidence and diversify sources of corporate funding so that the economic recovery can be sustained. While this responsibility largely rests on the shoulders of individual countries, however, there is scope for regional cooperation in this area to ensure that the reform package will take into account special characteristics of East Asian institutions and markets, the reform measures are harmonized at this early stage to facilitate regional integration later, and there is a coordinated approach to the implementation of the reforms while allowing flexibility to countries in the implementation in terms of timing and phasing. In its Hanoi Plan of Action, ASEAN has laid down specific areas of cooperation to strengthen the region's financial system with specific time line for implementation for some cases.<sup>6</sup> For example, ASEAN member countries have agreed to adopt and implement sound international financial practices and standards, where appropriate by 2003 and establish a set of minimum standards for listing rules, procedures and requirements by 2003. In so far as adoption of internationally accepted accounting standards, only 3 East Asian countries have fallen behind the rest of the countries in the region (**Table 7**).

For its part, APEC issued in 1997 voluntary principles for promoting financial and capital market development in member economies. The principles include, among others, encouraging member economies to adopt high standards in information disclosure and accounting, and ensure that the information is available in a timely manner; to develop

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<sup>4</sup> This partly draws on Dobson et al. (2003). They proposed a three-part road map for deeper regional cooperation consisting of strengthening domestic institutions and markets; developing regional arrangements and markets; and creating appropriate institutional structures.

<sup>5</sup> See Lamberte (2003).

<sup>6</sup> See Annex A for details.

effective, credible and independent rating agencies and, as appropriate, promote the greater use of ratings; and to consider efforts to make the legal and regulatory systems consistent with capital market development.<sup>7</sup>

The peculiar characteristics of Asian business landscape, such as predominance of family-run firms and diversity of legal and economic framework, demands homegrown good corporate principles and practices that are also in consonance with the internationally accepted body of governance principles. This is the main issue tackled by the ARCG. After three years of discussion, ARCG with the assistance of the OECD's Corporate Affairs Division serving as secretariat, the World Bank, the government of Japan, the Global Corporate Governance Forum, and ADB has developed a region-specific corporate-governance white paper that outlines common policy objectives and recommends practical reform agenda to improve corporate governance.<sup>8</sup>

There are still reform agenda wherein regional cooperation can bring more benefits to participating countries. For instance, the tax system may not have been geared towards supporting the development of the securities market. The required reform that will be undertaken by individual countries could take into account the need to harmonize the tax system for financial instruments among countries in the region to facilitate financial integration in the future. Currently, there is a considerable variation in the tax treatment of financial instruments among East Asian countries.<sup>9</sup>

#### Monetary cooperation and macroeconomic coordination

The ADB study identifies three stages of monetary cooperation at the macroeconomic level: information coordination and surveillance, resource coordination or reserve pooling, and exchange rate coordination. The ASEAN Surveillance Process (ASP) was established in October 1998 to strengthen the capacity of policy making within ASEAN on the principles of peer review and mutual interest among ASEAN member countries. It has two mechanisms: the monitoring mechanism that allows early detection of problems that might affect the economy, in general, and the financial sector, in particular; and a peer review mechanism that focuses on the policy measures needed to quickly address the issues identified in the monitoring exercises. Finance and central bank officials of ASEAN provide information on the latest economic and financial developments in their respective countries to the ASEAN Surveillance Coordinating Unit (ASCU), which in turn conducts analysis using such information and information about recent global developments.

With the formation of ASEAN+3 in 1999, the ASP was expanded to include China, Korea and Japan. Like ASP, the ASEAN+3 Surveillance Process provides a forum for policy dialogue and aims to strengthen policy coordination and collaboration in the region. Finance Ministers of this group meet twice a year. The first peer review conducted under this process was held in 2000. ADB's Regional Economic Monitoring Unit provides inputs to the ASEAN+3 economic monitoring and surveillance process.

The MFG is another mechanism for surveillance. Deputy Finance Ministers and central bank governors from member countries hold meetings twice a year with the participation of the IMF, World Bank, ADB and BIS. The presence of these four institutions in the meetings is

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<sup>7</sup> See Annex B for details.

<sup>8</sup> See OECD (2003).

<sup>9</sup> See Annex C.

expected to provide a high level and more intensive discussion of recent economic performance of member countries as well as regional and global developments.

Other aspects of information coordination and surveillance and those of reserve pooling and exchange rate coordination have been analyzed extensively elsewhere.<sup>10</sup> Suggestions on how to improve the existing processes will be discussed in the next section. What is tackled more extensively in this section is the development of regional financial and capital markets.

Considering that regional institutions have overlapping membership, it is not surprising to observe that practically all of them have expressed interest in developing the region's capital market to avoid the double mismatch problem that largely underpinned the recent regional crisis and to exploit the huge savings available in the region.<sup>11</sup> The regional bond market can be developed in parallel with the development of the domestic bond market of East Asian economies to exploit economies of scale. There are several Asian bond market initiatives that have been discussed in several fora in the last two years.<sup>12</sup> Accordingly, both the ASEAN+3 Asian bond market initiative and the APEC regional bond initiative are supposed to examine *supply side issues*, such as new debt instrument offerings, debt instrument rating and enhancements, infrastructure improvement, etc. To support the ASEAN+3 Asian Bond Market Initiative (ABMI), five working groups have been created to examine new securitized debt instruments, credit guarantee mechanisms, foreign exchange transactions and settlement system, issuance of bonds denominated in local currencies by multilateral development banks (MDBs), and local and regional rating agencies. The sixth group is the technical assistance coordination group. These groups have met to consider various proposals to develop the regional bond market.<sup>13</sup> In conjunction with the earlier discussion, one very important area for consideration is the harmonization of the tax system. Under existing conditions, combining the securities issued by different Asian countries into a pool which are used as underlying instruments for an asset-backed security to be issued by special purpose vehicle will present an administrative nightmare in computing tax liabilities of investors.

The Asian Bond Fund (ABF) initiative under the Executives' Meeting of East Asia Pacific Central Banks (EMEAP) will deal with *demand side issues*. On 2 June 2003, the EMEAP Group announced the launch of the ABF, which initially amounts to US\$1 billion. Managed by the Bank of International Settlements, the ABF will be invested in a basket of dollar denominated bonds issued by EMEAP economies' sovereign and quasi-sovereign issuers, except Japan, Australia and New Zealand. For its part, the Asia Cooperation Dialogue (ACD) is mandated to improve *public awareness* of the various bond market initiatives to secure political support for such initiatives.

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<sup>10</sup> Montiel (2003) gives an excellent overview.

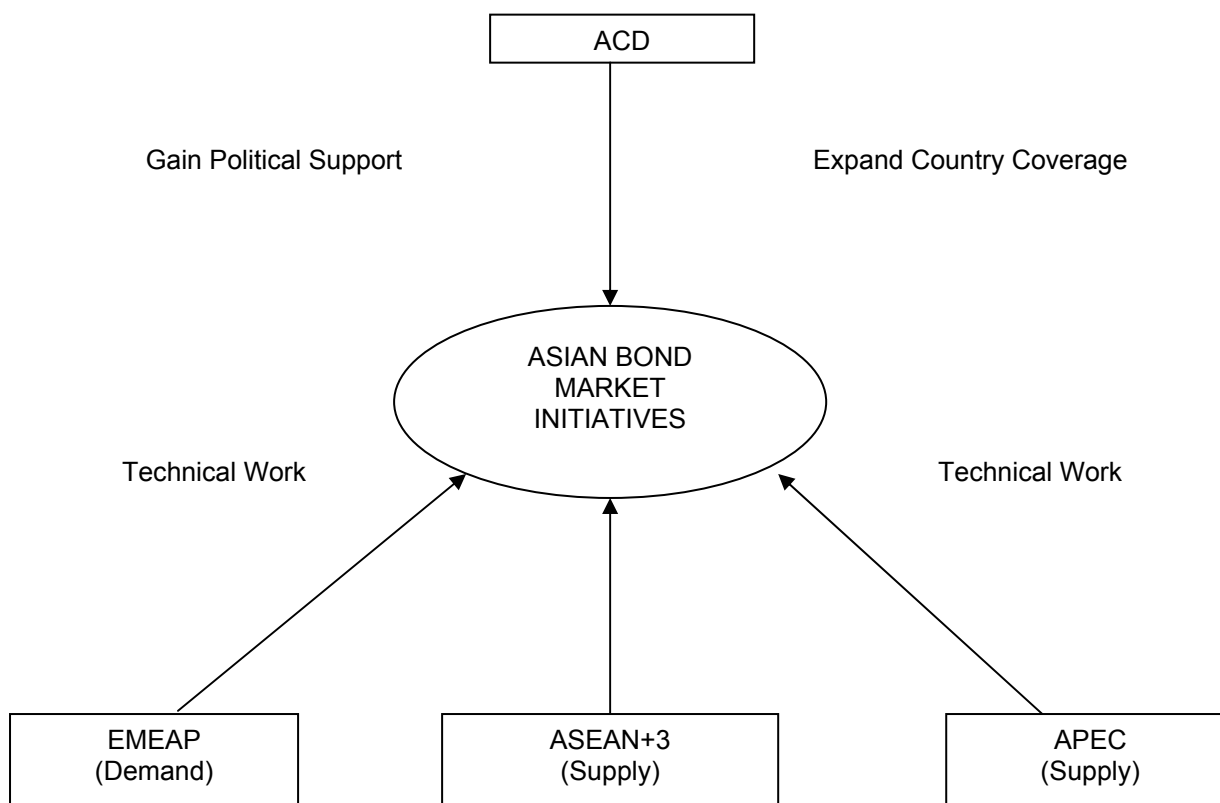
<sup>11</sup> Many have observed that East Asian countries continue to export "safe capital" and import "risk capital" after the financial crisis.

<sup>12</sup> Phuvanatanarubala (2003).

<sup>13</sup> For instance, proposals have been put forward by Ito (2003), Ho and Wong (2003), and Park and Park (2003).

**Figure 1** depicts the complementarity among the various Asian bond initiatives.

**Figure 1. Asian Bond Market Initiatives: Complementarity**



Source: Asian Development Bank.

### Capacity building

East Asian countries have various levels of economic development and capacities. Any endeavor especially if it is something new to the region, such as risk-based supervision, economic surveillance, etc., would require a capacity building program. ASEAN's ASP is supported by technical assistance from ADB. Both SEACEN and SEANZA offer training courses to senior and mid-level officials of central banks in the region. In some instances, the contents of their courses overlap.<sup>14</sup> APEC supports a financial regulators training initiative, which for the past 5 years has trained about 1,200 participants from APEC economies. ASEM has established the ASEM Trust Fund at the World Bank as an important measure giving technical assistance and advice both on restructuring the financial sector and on finding effective ways to redress poverty in the East Asian region. The ASEM Trust Fund activities are being fully coordinated with other funds and activities, such as allocations from the Japan Policy and Human Resources Development Programme. They emphasized the participation of beneficiary countries in selecting a project and the contents of the project.

<sup>14</sup> Examples of the courses they offer are shown in Annex D and Annex E.

## Research

Key regional institutions conduct research to address specific policy issues on regional cooperation. Overlaps in the research topics are not serious, and if ever they occur they add more benefits in the sense that new insights on the same policy issues have been generated or competing ideas of the same policy issues are being articulated. However, regional institutions conducting research seem to focus mainly on areas where they have comparative advantage or to fill up some gaps needed to support policy decisions. For instance, SEACEN focuses on central banking issues.<sup>15</sup> EMEAP completed, among others, a survey on national real time gross settlement systems (RTGSS) in the EMEAP region. ASEAN conducted a study on the feasibility of having a monetary and exchange rate arrangement among member countries. The Kobe project under ASEM is unique in the sense that the research program is designed to provide insights on regional policy issues and experiences from both the European and East Asian perspectives.<sup>16</sup> ADB also contributes to the research activities in the region in response to request by regional bodies, such as ASEAN and ASEAN+3.<sup>17</sup> The PECC Finance Forum has also provided an environment wherein research on monetary and financial cooperation can be undertaken and discussed in conferences.

Research on East Asian cooperation can be propelled to a higher ground and be better organized and coordinated with the establishment in September 2003 of the Network of East Asian Think-Tanks (NEATT).

## **V. Evaluation of Current Policy Structures**

The regional institutions and arrangements should be evaluated in terms of their contributions to the attainment of the vision shared by leaders and the people of East Asia. Among the institutions currently in place in East Asia, the ASEAN+3 group seems to be in the best position to articulate that vision. Once clearly articulated, a road map of regional cooperation can be created that would lead to the realization of that vision. Its weakness, however, is that it does not have a permanent secretariat that supports decision-making process and initiatives of the group.

At present, East Asian countries seem to have no clear, unified idea of the end-game of the multiplicity of regional cooperative arrangements they have forged so far. Recently, Singapore's Prime Minister Goh Chok Tong said that ASEAN will become an economic community well before 2025 where there will be free flow of goods, services, investment and capital.<sup>18</sup> ASEAN will be the hub linking other growth areas in the region, such as China, India, Japan and Korea. The process of integration will be market-driven, not institution-based. Earlier, however, Malaysian Prime Minister Mohamad was quoted pushing for an East Asia Economic Grouping backed by the proposed regional monetary fund independent of the IMF.<sup>19</sup> He further said that East Asian countries must stop hiding behind the spurious name

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<sup>15</sup> See Annex D for SEACEN's research agenda for 2003.

<sup>16</sup> The Kobe project research agenda are: Exchange Rate Regimes for Emerging East Asian and EU Accession Countries; Requirements for Successful Currency Regimes: Lessons for East Asia, Regional Financial Cooperation and Surveillance, Regional Economic Integration in East Asia and Europe, Banking Sector Reform and Capital Market Development.

<sup>17</sup> ADB also participates in the Kobe project.

<sup>18</sup> Dow Jones Business News, 23 October 2003.

<sup>19</sup> AFP (June 2003).

of ASEAN+3 and come out openly and call themselves East Asia Economic Grouping, which will be outward-looking. The East Asian Vision Group, a creation of ASEAN+3, has recommended the evolution of the annual summit meetings of ASEAN+3 into the East Asian Summit and for the establishment of an East Asian community. This vision has a large implication on the form and content of the regional cooperative arrangements including monetary and financial cooperation in East Asia. Under this vision, ASEAN will no longer be the main driving force of change in the region and the +3 countries will no longer be an appendix to ASEAN cooperation. Instead, all members having equal status in this grouping will collectively work for the realization of the shared vision of having an East Asian community.

Some members of ASEAN may raise some objections to this because it may lead to the marginalization of some members, especially the transition economies, and may disproportionately elevate the dominance of China and Japan in the community. However, a policy structure that supports the narrowing of the economic differences among member countries, a mechanism that guarantees that each will be given a fair share in policy formulation, and a regional institution that can provide safety nets to those that will be temporarily left out in the integration process can help allay those fears. The debate on this issue should be given top priority in the East Asian agenda and a policy decision needs to be made so that appropriate institutions can be put in place or existing ones can be refurbished to support the policy. During their summit meeting in November 2002, the ASEAN+3 leaders expressed willingness to explore the phased evolution of the ASEAN+3 summit into an East Asian summit. This can be the beginning of the change in the vision for East Asia.

In our view, East Asian integration will likely accelerate in the coming years especially if most ASEAN countries or ASEAN as a whole forge a free trade agreement with the +3 countries. It would therefore make sense to start the process of transforming the ASEAN+3 into an East Asian Economic Community or Grouping as suggested by various quarters. To pursue the vision, East Asia needs an institutional structure to perform important tasks, such as outlining the appropriate mechanisms for cooperation, coordinating various programs that may be spearheaded by individual members of the group, etc. In this regard, the ASEAN Secretariat can evolve into the Secretariat of the East Asian Economic Community.

A policy structure that will give utmost priority to the strengthening the domestic economies of East Asia needs to be put in place. In some instances, this will require new regional cooperative arrangements. For example, the ADB study proposes the eventual launching of an Asian Monetary Cooperation Fund (AMCF) that can be dovetailed to the aforementioned Secretariat of the East Asian Economic Community. This will facilitate the implementation of the main proposals related to stronger regional economic surveillance and enhanced regional resource pooling, thus.<sup>20</sup>

- What is required is a regular and mandatory surveillance process based on specific and clearly identified information provided to a regional policy dialogue whose report to a forum of senior policymakers from the region should cover a broad range of observable policies. This forum should meet regularly to discuss country reports and evaluate country policies, and eventually its key recommendations should be made public.

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<sup>20</sup> Quoted from Montiel (2003). The synopsis is based on background papers prepared by Eric Girardin, Olarn Chairavat, and Yunjong Wang and Wing Thye Woo.



- An adequate arrangement for regional reserve pooling requires extending the Chiang Mai Initiative into a centralized, multilaterally administered arrangement with substantially larger stocks of resources than are presently available and with the availability of resources increasingly independent of an arrangement with IMF.
- The resources from the Asian resource pool may need to be comparable in size to those available from IMF.
- The timing of the activation of the regional resource pool would thus be determined by that required to accumulate the requisite expertise within a regional secretariat to conduct due diligence on potential borrowers from the pool, to design appropriate conditionality, and to monitor performance. The AMCF would perform these functions.

Meanwhile, the East Asian Banking Advisory Committee (EABAC) can be established to serve as a forum where regional guidelines for prudential supervision can be set up along with the extension of the supervisory function within each country to all institutions that engage in banking activities. The ADB study has proposed for the EABAC to be comprised of high-level representatives of the participating countries' supervisory authorities and finance ministries. The EABAC should meet four times a year and would be assisted by the newly established secretariat that could be housed at the AMCF.

The proposals of ARCG to improve corporate governance of financial and nonfinancial firms in Asia could be brought up to the official level of regional cooperation. The Secretariat could then be tasked to assess them before sending them to the decisionmakers in the East Asia Economic Community and, once implemented, coordinate their activities.

Discussions regarding the development of both the domestic and regional bond markets have progressed from more general issues to more specific issues. There is a consensus that legal (such as insolvency law), tax and financial infrastructure for the development of the bond market still needs to be strengthened or put in place. Harmonization of the legal framework, such as insolvency law, asset-backed securities law, and tax policies can be a major regional cooperative endeavor for East Asia, but work on this area seems to be lagging behind other initiatives.

As part of the financial infrastructure, credit rating agencies can play a big role in this market. To attract funds into the nascent bond market of East Asia, bond issues need to be rated by reputable and independent credit rating agency. None of the existing CRAs in Asia can qualify for this, and given the small size of the domestic bond market in each country, except in the case of Japan, no domestic CRA can upgrade its capacity and still remain viable. A regional credit rating agency with international reputation that rates both domestic and regional bonds can be developed, and policies need to support such development.

With this infrastructure in place, credit enhancement for regional bonds will be useful and, if needed, will likely be less costly to both corporate bond issuers and providers of credit-enhancement services than if it were absent.

The newly formed NEATT can certainly help support financial change and development in East Asia. The governments in East Asia are in the best position to support the network financially. However, NEATT can contribute more to the process of forging closer financial cooperation if it remains in the track 2 mode so that fresh ideas about cooperative arrangements can be debated by academics and experts without being censured by their

respective governments. It can help define the policy issues that need to be studied well by member research institutes. As part of its initial activities, NEATT can develop a website linking all member institutions so that each will know what others are studying or have completed studies relevant to regional financial cooperation. The research activities of other regional institutions, such as those of EMEAP, SEACEN, ASEM-Kobe project and PECC can complement the work of the NEATT.

Finally, policy debate on possible expansion of ASEAN+3 or East Asian Community to include Australia and New Zealand can be initiated, albeit policy decision on this matter can be given less priority over the deepening of integration among the existing ASEAN+3. Two-way trade between Australia and ASEAN amounting to about US\$24 billion is not insignificant. Australia has already an FTA with Singapore, and presently is in the process of completing another FTA with Thailand. The inclusion of Australia and Thailand in the East Asian Economic Community can contribute to the dynamism of the region, not to mention the fact that both can provide a counterweight to China's and Japan's participation in the group. There is also an issue of what to do with Taipei, China, which will become a free-rider in the zone of economic and financial stability and prosperity that will be brought about by closer economic and financial cooperation in East Asia.

## **VI. Concluding Remarks**

The proliferation of regional institutions in the wake of the financial crisis seems like the entry of so many banks right after bank liberalization. Sooner or later, there will be consolidation to weed out weak, redundant institutions. This paper has reviewed the functions and activities of regional institutions and arrangements that help promote financial change and development in East Asia. ASEAN+3 is likely to play an important role in forging cooperative arrangements that promote closer monetary and financial integration in the future. However, it has to clearly articulate its vision for the region so that appropriate institutions can be put in place or existing ones can be refurbished to support the realization of that vision. Transforming ASEAN+3 into an East Asian Economic Community with a permanent support institution will be a big challenge facing policy makers in the region in the near term.

This paper has emphasized the need for regional collaborative efforts to strengthen the domestic financial system without necessarily diminishing the value of the current efforts to develop regional financial markets and financial arrangements. One other concern that should be mentioned is the need to keep in mind the other causes of the 1997 financial crisis. Emphasis on regional and financial cooperation may cause analysts to lose track of the role of private capital flows in precipitating the crisis. There have been proposals made to address this issue (e.g., bail-in measures and collective action clauses on the part of international creditors) but not much progress has been made in this area. Stronger regional cooperation could enhance East Asian influence in multilateral organizations and in negotiations over the international financial architecture.

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## Annex A

### **Strengthen Macroeconomic and Financial Cooperation<sup>21</sup>**

To restore confidence, regenerate economic growth and promote regional financial stability through maintaining sound macroeconomic and financial policies as well as strengthening financial system and capital markets enhanced by closer consultations, so as to avoid future disturbances.

- 1.1. Maintain regional macroeconomic and financial stability.
  - 1.1.1. Strengthen the ASEAN Surveillance Process; and
  - 1.1.2. Structure orderly capital account liberalization.
- 1.2. Strengthen financial systems.
  - 1.2.1. Adopt and implement sound international financial practices and standards, where appropriate by 2003;
  - 1.2.2. Coordinate supervision and efforts to strengthen financial systems;
  - 1.2.3. Develop deep and liquid financial markets to enable governments and private firms to raise long-term financing in local currency, thereby reducing the over dependence on bank finance and limiting the risks of financial crisis;
  - 1.2.4. Adopt and implement existing standards of disclosure and dissemination of economic and financial information; and
  - 1.2.5. Adopt prudential measures to mitigate the effects of sudden shifts in short-term capital flows.
- 1.3. Promote liberalisation of the financial services sector.
  - 1.3.1. Intensify deregulation of the financial services sector; and
  - 1.3.2. Intensify negotiations of financial sector liberalisation under the ASEAN Framework Agreement on Services (AFAS).
- 1.4. Intensify cooperation in money, tax and insurance matters.
  - 1.4.1. Study the feasibility of establishing an ASEAN currency and exchange rate system;
  - 1.4.2. Establish an ASEAN Tax Training Institute by 2003;
  - 1.4.3. Enhance the role of "ASEAN Re Corporation Limited" as a vehicle to further promote regional cooperation in reinsurance business; and
  - 1.4.4. Establish an ASEAN Insurance Training and Research Institute by 2003.
- 1.5. Develop ASEAN Capital Markets.
  - 1.5.1. Adopt and implement internationally accepted practices and standards by the year 2003, and where appropriate at a later date especially for the new Member Countries;
  - 1.5.2. Establish a set of minimum standards for listing rules, procedures and requirements by 2003;
  - 1.5.3. Coordinate supervision of and programs to strengthen capital markets;
  - 1.5.4. Improve corporate governance, transparency and disclosure;

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<sup>21</sup> Excerpt from the Hanoi Plan of Action (1998).

- 1.5.5. Develop a mechanism for cross-listing of SMEs among ASEAN capital markets by 2003, and where appropriate at a later date for the new Member Countries;
- 1.5.6. Facilitate cross-border capital flows and investments;
- 1.5.7. Facilitate clearing and settlement systems within ASEAN;
- 1.5.8. Promote securitisation in ASEAN;
- 1.5.9. Foster collaborative and cooperative networks among capital market research and training centres in Member States;
- 1.5.10. Prepare the framework to develop bond markets in ASEAN by 2000; and
- 1.5.11. Promote networking among development banks in Member States for financing of productive projects.

## **Annex B**

### **Voluntary Principles in Promoting Financial and Capital Market Development<sup>22</sup>**

*Voluntary Principles to Attain Core Conditions.* We recognized that the task of achieving efficient savings and investment intermediation is not easy. It calls for major efforts by economies, in close collaboration with market participants in the private sector, to strive towards achieving certain core conditions as follows: (i) a sound macroeconomic environment; (ii) stable and transparent legal and regulatory systems; (iii) well-developed market infrastructure; (iv) efficient financial and capital markets institutions; and (v) an array of available financial instruments to meet the region's diverse financing and investment needs.

Recognizing the importance of promoting financial and capital market development in sustaining the growth momentum of the APEC region and in mobilizing longer-term capital for infrastructure investment, we agreed to the following voluntary principles designed to help the APEC member economies in achieving the core conditions.

*Sound Macroeconomic Environment.* The pursuit of sound macroeconomic policies is an essential element in maintaining strong banking systems and a prerequisite to the development of capital markets, including long-term debt markets. Member economies shall aim towards creating and maintaining a sound macroeconomic environment through prudent monetary, fiscal and exchange rate policies.

*Stable and Transparent Legal and Regulatory Systems.* The legal and regulatory systems of economies may involve features that inadvertently inhibit capital market development. It is desirable that member economies consider efforts to make the legal and regulatory systems consistent with capital market development. Sound financial regulation and supervision is critical to capital market development. Where applicable, member economies shall develop a professional cadre of regulators and supervisors with the appropriate competence and training. Financial regulators and capital market supervisors shall strengthen and expand existing linkages with each other to promote the soundness of the financial system and the protection of investors, so as to reap the benefits and address the challenges of expanding cross-border capital flows.

*Well-Developed Market Infrastructure.* High quality, transparent and comparable reporting and disclosure on the financial positions of businesses promote investor interest in capital markets. Member economies shall encourage the adoption of high standards in information disclosure and accounting, and ensure that the information is available in a timely manner. A well-organized, up-to-date and easily accessible database for macroeconomic information can assist investors make well-informed business decisions. Member economies shall make available such information to all investors. Effective, credible and independent credit rating agencies are important in developing domestic bond markets, particularly because of the assurance they offer investors that certain credit risks can be properly assessed. Member economies will encourage the development of effective, credible and independent rating agencies and, as appropriate, promote the greater use of ratings. Well-developed and efficient clearing and settlement systems are indispensable to the development of capital markets. In

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<sup>22</sup> This is Annex 2 of the Ministerial Statements at the conclusion of the 4<sup>th</sup> APEC Finance Ministerial Meeting held on 5-6 April 1997.



this context, member economies shall take the appropriate steps to facilitate the development of modern clearing and settlement systems to minimize transaction costs and settlement risks.

*Financial and Capital Market Instruments.* Market-based benchmark rates for medium to long term securities facilitate more accurate pricing and encourage the development and deepening of the bond market, including that for municipal bonds. Member economies will consider the costs and benefits of issuing government bonds or of encouraging the issuance of other securities to establish such reference rates.

## Annex C

### Tax Treatment of Passive Incomes in Selected Countries in Asia-Pacific Region

| Country          | Types of Passive Income  |  |   |   |  |
|------------------|--|--|---|---|--|
|                  | Dividends  | Interest   | Royalties   | Capital Gains   | Rentals/Others   |
| Australia        | <p><i>Resident</i><br/>Aggregated with other incomes.</p> <p>Employs an imputation system, i.e., the tax payable by a company on profits of which dividends are paid is fully creditable against the income tax liability of the resident individual shareholder.</p> <p>The same applied for intercorporate dividends, but each resident company is required to maintain a franking account.</p> <p><i>Non-resident</i><br/>Expenditures incurred are deductible. Generally, 30% withholding but where there is a double-tax agreement in place, the rate is generally 15%.</p> | <p><i>Resident</i><br/>Aggregated with other incomes.</p> <p><i>Non-resident</i><br/>Generally, subject to a withholding tax of 10% except in the case of bearer debentures which are subject to 47% withholding tax whose name and address of the debenture holders is not known.</p> | <p>Aggregated with other incomes and are generally not subject to a withholding tax, except in the case of film royalties earned by non-residents and deemed to have an Australian source. Film royalties are generally subject to a 10% final withholding tax.</p> | <p>Capital gains are included in the assessable income on net basis, i.e., the excess of the disposal price over the cost base. Acquisition cost plus improvements are indexed for inflation.</p> <p>Excess capital losses can be carried forward indefinitely under certain conditions, like continuity of ownership or passing a business test. Transfer of net capital losses amongst a group of companies is allowed subject to certain conditions.</p> | <p><i>Resident</i><br/>Aggregated with other incomes.</p> <p><i>Non-resident</i><br/>No specific withholding tax provision is applied, except when the income accrues to a non-resident in Australia, where the lessee is required to withhold tax on rental payments.</p> |
| Chinese - Taipei | <p>Dividends distributed to non-resident shareholders by corporations, profits distributed to non-resident members of</p>  | <p>Any interest received from public debentures, corporate notes, treasury bonds, any short-term commercial papers,</p>  | <p>Any income from lease or license of property, patent, trademark, copyright, know-how, or other franchise, or</p>   | <p>Gains received from sporadic sale, exchange or other disposition of property or right by a taxpayer that comes to possess</p>  | <p>Rental income from properties lent to others for use in line with the local prevailing rental standard is subject to a 10%</p>  |

| Country   | Types of Passive Income   |   |  |  |   |
|-----------|---|---|--|--|---|
|           | Dividends   | Interest  | Royalties  | Capital Gains  | Rentals/Others  |
|           | cooperative organizations, profits distributed to non-resident partners by partnerships, and profits earned by non-resident proprietors are subject to a 30% withholding tax or 20% if the investment is approved under the Statute of Investment by Foreign Nationals or the Statute for Investment by Overseas Chinese.   | deposits and other loans are subject to a 10% withholding tax for residents and 20% withholding tax for non-residents. On short-term commercial papers, the withholding tax is 20% for residents.   | from the use of money obtained in consideration or possession/use lie on real estate are subject to a 15% withholding tax for residents and 20% withholding tax for non-residents.   | the property other than engaging in regular sales and purchases of such properties for profit-seeking purposes are subject to the deed tax.<br><br>Gains received through the sale or exchange of stocks or other securities are stock transactions tax. | withholding tax for residents; and 20% withholding tax for non-residents. |
| Indonesia | Dividends received by resident individuals are aggregated with other sources of income, except those intended to reduce paid-up capital; payment of redemption of profit rights; profit distribution of bonds participating in company's expenses incurred for the personal needs of shareholders.<br><br>A creditable withholding tax of 15% for residents and 20% final tax for non-residents are imposed.<br><br>Dividends received by a resident company from another resident company are exempt from income | Aggregated with other incomes. Except interest from small savings of individuals owning self-occupied low-priced houses or flats; those realized from time deposits and savings by the Indonesian Red Cross, approved pension funds from deposits with non-banking financial institutions in Indonesia and others which are subject to a final tax.<br><br>A creditable withholding tax of 15% for residents and 20% final tax for non-residents are imposed. | Aggregated with other income. Expenses incurred in earning, recovering and securing royalty income can be deducted by residents while credit is granted on foreign tax paid on foreign-source royalties. A creditable withholding tax of 15% on gross royalties and a 20% final withholding tax on non-resident recipient are imposed. | Capital gains are aggregated with ordinary income except gains from selling securities which are taxed at 0.1% of the selling price.   |   |

| <b>Country</b> | <b>Types of Passive Income</b>   |   |  |  |                       |
|----------------|--|---|--|--|-----------------------|
|                | <b>Dividends</b>   | <b>Interest</b>   | <b>Royalties</b>   | <b>Capital Gains</b>   | <b>Rentals/Others</b> |
|                | <p>tax while dividends from foreign sources are taxed as ordinary income.</p> <p>Starting 2001, dividends or share of profit received or accrued by a limited liability company as a resident taxpayer, cooperatives, state-owned companies, through ownership in an enterprise established and domiciled in Indonesia, subject to the following conditions:</p> <ol style="list-style-type: none"> <li>1. dividends are paid out of retained earnings;</li> <li>2. limited liability companies and state-owned companies receiving the dividends must own at least 25% of the total paid-in capital and must have an active business in addition to the ownership.</li> </ol> |   |  |  |                       |
| Japan          | <p>Intercorporate dividends are generally exempt from tax. However, if a domestic corporation receives dividends in a small shareholding in another domestic corporation, 80% of the dividends is exempt</p>   | <p>Interest income of a domestic corporation is aggregated with its worldwide income and is subject to the corporate income tax. Interest income of corporations realized from sources within Japan are</p> | <p>Royalties are aggregated with ordinary income from business operation by an individual or a corporation. In the case of foreign corporations, only domestic service</p> | <p>Capital gains realized by corporations are taxed as ordinary income at normal rates and capital losses are fully deductible. Special deductions are granted to certain transfers of land such as: sale of</p> |                       |

| Country  | Types of Passive Income  |   |  |  |  |
|----------|--|---|--|--|--|
|          | Dividends  | Interest  | Royalties  | Capital Gains  | Rentals/Others   |
|          | while the remaining 20% are aggregated with the corporation's taxable income. The base is net of deductible interest. Dividends received by individuals can be taxed separately with a final tax of 20% or 25% under certain conditions. | taxable. Interest received by individuals can be taxed separately with a final tax of 15% under certain conditions.   | royalties are subject to corporate income tax.   | land to Urban Housing Development Corporation or to the national or local government up to million yen; sale of land to housing developers up to 15 million yen; and transfer of agricultural land for the purpose of rationalizing agricultural landholdings up to 8 Million yen.   |  |
| Korea    | Aggregated with ordinary income and taxed accordingly.   | Taxed as ordinary business income.  | Taxed as ordinary income.  | Capital gains realized by individuals from the sale of land, buildings and sale of stocks are taxed separately.  |  |
| Malaysia | Aggregated with other items of income for tax with provision for deduction of certain expenses. Malaysia applies a full imputation method.   | Aggregated with other incomes and taxed at the appropriate rate applicable to resident taxpayers.<br><br>Non-residents earning interest income from Malaysian sources is taxed at 15% on gross. | A resident is taxed on royalties derived both within and outside Malaysia. Royalties are aggregated with other incomes.<br><br>A non-resident is taxed on royalties accruing in or derived from Malaysia at 15% final withholding tax. | As a rule, capital gains are not subject to income tax except gains derived from the disposal of any real property or interest or other rights over land situated in Malaysia or disposal of shares in a "real property company" which are subject to the following rates both for the individual and company:<br><br>- if period for disposal is within 2 Years - - - 20%<br><br>- if on the 3rd year - - - 15% | Aggregated with other sources of income of an individual or a company. Rental and leasing income of a non-resident, however, is taxed at 15% and foreign tax on rental and leasing income remitted to Malaysia is allowed as a credit against Malaysian tax. |

| Country     | Types of Passive Income  |  |  |  |   |
|-------------|--|--|--|--|---|
|             | Dividends  | Interest   | Royalties  | Capital Gains  | Rentals/Others  |
|             |  |  |  | <p>- if on the 4th year - - - 10%</p> <p>- if on the 5th year - - - 5%</p> <p>- subsequent years - - - 5% for company and nil for individual</p> |   |
| New Zealand | <p>Aggregated with other incomes and with provision for imputation.</p> <p>Dividends received by resident companies from non-resident companies after 1 April 1992 continue to be exempt from income but are subject to the withholding payment rules on dividends.</p> <p>Dividends received by resident companies from other resident companies after 1 April 1992 are part of assessable income. Any imputation credits attached to such dividends are also included in the assessable per cent.</p> <p>Dividends received by non-residents from New Zealand are subject to final withholding tax of 30% or 15% under a tax treaty.</p> | <p>Aggregated with other incomes.</p> <p>Initially subject to a resident withholding tax of 24% or 33% if the lender's IRD number is not provided to the borrower.</p> <p>Interest derived from the National Development Bonds or New Zealand Savings Certificates are exempt up to NZ\$500 and with certain qualifications.</p> | <p>Aggregated with other incomes.</p> <p>No exemptions and no rebates allowable against income from royalties.</p> | <p>With some exceptions, capital gains are not subject to tax.</p>   | <p>All receipts from leasing of land, rents, fines, premiums, including payments of goodwill are assessable income.</p> |

| <b>Country</b> | <b>Types of Passive Income</b>  |  |  |   |  |
|----------------|---|--|--|---|--|
|                | <b>Dividends</b>  | <b>Interest</b>  | <b>Royalties</b>   | <b>Capital Gains</b>  | <b>Rentals/Others</b>  |
| Philippines    | <p>Dividends received by domestic corporations from another domestic corporation including the share in a partnership taxable as a corporation are exempt from tax starting July 1986.</p> <p>Dividends received by a non-resident foreign corporation, not engaged in trade or business in the Philippines are taxable at 32% of the gross dividend income received from all sources within the Philippines, except under a tax sparing provision.</p> <p>Dividends received by citizens and resident aliens are taxable at 10%.</p> | <p>Interest from Philippine currency bank deposits is subject to a final withholding tax of 20% when received by citizens, resident aliens, domestic corporations and resident foreign corporations.</p> <p>Interest income received from sources within the Philippines by non-resident aliens not engaged in trade or business in the Philippines is subject to 25% tax on gross. Those of non-resident foreign corporations are taxed at 32% on gross.</p> <p>Interest income from foreign currency deposits of non-resident individuals is exempt from tax. Residents or alien citizens are taxed at 7.5%.</p> | <p>When received by non-resident aliens, not engaged in trade or business and foreign corporations, the tax is 25% and 32% on gross, respectively.</p>   | <p>Capital gains from the sale of Shares or stock and traded in the local stock exchange are exempt from income tax, but subject to a stock transactions tax of 1/2 of 1% of the gross selling price.</p> | <p>Prizes in excess of P10,000 and winnings except Philippine Charity Sweepstakes and lotto winnings are taxable at the final withholding rate of 20%.</p>                             |
| Singapore      | <p>Dividends are aggregated with other incomes and with provision for imputation. Under the imputation system, the shareholder's tax on the dividend income is adjusted by the company tax paid on the dividend through a tax credit method.</p>  | <p>Interest income is assessable with other incomes. Residents are subject to tax on all Singapore source interest as well as those remitted to Singapore.</p> <p>Non-residents with an establishment in Singapore are taxable on interest income in the same</p>  | <p>Resident companies and individuals and non-resident companies with a permanent establishment in Singapore are taxable on Singapore source royalties received in Singapore. Temporary residents, non-resident individuals and non-resident companies are</p> | <p>Capital gains are not subject to tax in Singapore.</p>   | <p>Rental and leasing income arising from movable and immovable property, including rents and other profits arising from property is aggregated with other incomes subject to tax.</p> |

| Country  | Types of Passive Income  |   |  |   |  |
|----------|--|---|--|---|--|
|          | Dividends  | Interest  | Royalties  | Capital Gains   | Rentals/Others   |
|          |  | manner as residents. Non-residents without an establishment in Singapore are taxable only on Singapore source interest earnings.  | taxable only with respect to Singapore source royalties.   |   |  |
| Thailand | <p>Corporate dividends are exempt from income tax effective 1 January 1992 under certain conditions. If any of the conditions are not met, one-half of the dividend income is taxable. Foreign source dividends received by a Thai company are subject to tax and those paid to non-resident companies are subject to a 10% tax. Withholding of a creditable tax on dividends, shares of profit is 10%.</p> <p>Dividends received by individuals are subject to 10% tax, which can be considered final at the choice of the taxpayer, or can be entitled to a tax credit of 3/7 of the amount of the dividends received.</p> | <p>Interest income forms part of assessable income subject to the following creditable withholding tax:</p> <ul style="list-style-type: none"> <li>- paid to a non-resident juristic company carrying on banking, insurance, or other like business - 15%</li> <li>- paid by the government or by a financial institution organized under a special law to promote agriculture, commerce, or industry - 1%</li> <li>- interest on unpaid purchase price - nil</li> <li>- interest on foreign loans - nil</li> <li>- other interest - 15%</li> </ul> <p>Interest income received by individuals is subject to 15% tax rate, which can be considered final at the choice of the taxpayer.</p> | <p>Royalties, technical assistance and management fees arising from the licensing of patents, copyrights, franchises, and other rights are subject to a creditable withholding tax of 15%.</p> | <p>Capital gains are taxed as part of the aggregate ordinary income. Foreign exchange gains, which are unrealized gains, i.e., those resulting from the drop in the buying rate for a foreign exchange on the closing date of the accounting Period in respect of a debt in that Foreign currency must be included as income except in some instance.</p> | <p>Rental income and other forms of income are assessed together with other incomes.</p> |

Source: Study Group on Asian Tax Administration and Research (SGATAR) 2002.



## Annex D

### SEACEN Research and Training Programs for 2003

| <b>Program</b>      | <b>Title</b>   |
|---------------------|--|
| A. Research         | <ol style="list-style-type: none"><li>1. Bank Restructuring in Selected Emerging Economies: Rationale, Consequences and Strategies</li><li>2. Regulatory Framework and Risk Management of E-Money: A Comparative Review of Central Bank Practices</li><li>3. Managing and Monitoring Direct and Portfolio Investment Flows: A Comparative Study of the SEACEN Countries</li><li>4. Dynamics of the Inflation Process in the SEACEN Countries</li></ol>   |
| B. Training         |  |
| 1. Training Courses | <ol style="list-style-type: none"><li>1. 40th SEACEN-Fed Course on Banking Supervision (Intermediate Level): Market Risk Analysis</li><li>2. SEACEN-Federal Reserve System Course on Electronic Banking and Technology Risk Supervision</li><li>3. 2nd SEACEN-CPSS Course on Payment and Settlements Systems</li><li>4. 3rd SEACEN Course on Monetary Policies and Strategies</li><li>5. SEACEN Course on Currency Management</li></ol>  |
| 2. Seminars         | <ol style="list-style-type: none"><li>1. Seminar on Development of Micro-Finance Activities in SEACEN Countries</li><li>2. 4th SEACEN/Fed/World Bank Seminar for Senior Bank Supervisors from Asia-Pacific Economies</li><li>3. 3rd SEACEN-Toronto Center Leadership Seminar for Senior Management of Central Banks on Financial System Oversight</li><li>4. Seminar on WTO and Liberalisation of the Financial Services Sector in SEACEN Countries</li><li>5. SEACEN/World Bank/IMF Seminar on Comparative Experiences in Confronting Banking Sector Problems in the Asia/Pacific Region</li><li>6. SEACEN-BIS Seminar on Central Bank Governance</li></ol> |
| 3. Workshops        | <ol style="list-style-type: none"><li>1. Workshop on International Investment Position (IIP) in SEACEN Countries</li><li>2. SEACEN-BIS Workshop on Strengthening the Management of International Capital Flows</li><li>3. 6th SEACEN-FSI Workshop for Bank Supervisors and Regulators: The New Capital Accord and Credit Ratings</li><li>4. Workshop on Financial Stability and Financial Soundness Indicators</li><li>5. 7th SEACEN-FSI Workshop for Bank Supervisors and Regulators: The New Capital Accord and Financial Engineering from a Practical View</li></ol>  |

Source: SEACEN website, [www.seacen.org](http://www.seacen.org).

## Annex E

### **25th SEANZA Central Banking Course 15-27 November 2004**

- |           |   |
|-----------|---|
| Module 1: | Central Banking: An Overview  |
| Module 2: | Monetary Policy Framework   |
| Module 3: | Exchange Rate Policy  |
| Module 4: | Monetary Policy Implementation; Linkages with fiscal policy and financial markets |
| Module 5: | Financial Sector Stability  |
| Module 6: | Banking Supervision   |
| Module 7: | International Developments in Banking   |
| Module 8: | Payment and Settlements Systems   |

*Source: Bangko Sentral ng Pilipinas.*

**Table 1 : Summary, intra-ASEAN exports as a percentage of all exports, by ASEAN country 1996 to 2000**

| <b>Country</b> | <b>1996</b> | <b>1997</b> | <b>1998</b> | <b>1999</b> | <b>2000</b> |
|----------------|-------------|-------------|-------------|-------------|-------------|
| Brunei         | 17.9        | 18.3        | 11.5        | 16.0        | 29.5        |
| Cambodia       | na          | na          | na          | 23.4        | 5.6         |
| Indonesia      | 15.4        | 17.3        | 19.1        | 17.0        | 17.5        |
| Lao PDR        | na          | na          | na          | na          | na          |
| Malaysia       | 30.6        | 30.0        | 28.0        | 26.0        | 24.9        |
| Myanmar        | na          | na          | na          | 32.1        | 33.0        |
| Philippines    | 15.2        | 13.6        | 13.0        | 14.2        | 15.7        |
| Singapore      | 29.3        | 27.9        | 23.7        | 25.5        | 27.3        |
| Thailand       | 21.7        | 23.4        | 16.8        | 17.6        | 27.3        |
| Vietnam        | 33.5        | 20.6        | 25.4        | 21.8        | 18.3        |
| <b>ASEAN</b>   | <b>25.2</b> | <b>24.8</b> | <b>22.0</b> | <b>21.9</b> | <b>23.8</b> |

Source: Dennis and Yusof (2003)

**Table 2. Intra-ASEAN FDI as a percentage of total FDI by host country, 1995-2000**

| <b>Host country</b> | <b>1995</b> | <b>1996</b> | <b>1997</b> | <b>1998</b> | <b>1999</b> | <b>2000</b> |
|---------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Brunei              | 53.4        | 54.0        | 54.9        | 43.1        | 46.2        | 36.2        |
| Cambodia            | na          | na          | na          | na          | Na          | na          |
| Indonesia           | 14.0        | 3.1         | 5.8         | -11.7       | -15.6       | -5.1        |
| Lao PDR             | 7.4         | 80.2        | 74.6        | 62.5        | 62.9        | 41.0        |
| Malaysia            | 30.2        | 19.8        | 41.2        | 15.4        | 11.4        | 4.6         |
| Myanmar             | 30.4        | 39.4        | 36.8        | 22.5        | 13.5        | 35.4        |
| Philippines         | 13.0        | 4.5         | 10.8        | 6.1         | 6.7         | 5.1         |
| Singapore           | 7.0         | 3.8         | 20.6        | 2.4         | 4.1         | 2.5         |
| Thailand            | 8.0         | 13.6        | 8.2         | 7.7         | 9.3         | 11.9        |
| Vietnam             | 21.8        | 18.2        | 21.1        | 23.5        | 19.5        | 15.7        |
| <b>ASEAN</b>        | <b>15.2</b> | <b>10.2</b> | <b>19.8</b> | <b>9.6</b>  | <b>8.5</b>  | <b>9.4</b>  |

Source: Dennis and Yusof (2003)

**Table 3. Regional Fora for Finance Ministries and Central Banks**

|                          | Financial Ministries and/or Central Banks |                 |                          |              |             |                           | Central Banks  |                |               |
|--------------------------|---|-----------------|--------------------------|--------------|-------------|---------------------------|----------------|----------------|---------------|
|                          | ASEAN<br>(10)                             | ASEAN+3<br>(13) | MFG <sup>a</sup><br>(14) | APEC<br>(21) | ACD<br>(22) | ASEM <sup>b</sup><br>(25) | SEANZA<br>(20) | SEACEN<br>(12) | EMEAP<br>(11) |
| Year Established         | 1967                                      | 1999            | 1997                     | 1994         | 2002        | 1997                      | 1956           | 1966           | 1991          |
| Japan                    |   | *               | *                        | *            | *           | *                         | *              |                | *             |
| China                    |   | *               | *                        | *            | *           | *                         | *              |                | *             |
| Korea                    |   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Hong Kong                |   |                 | *                        | *            |             |                           | *              |                | *             |
| Chinese Taipei           |   |                 |                          | *            |             |                           |                | *              |               |
| Singapore                | *   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Brunei                   | *   | *               | *                        | *            | *           | *                         |                |                |               |
| Cambodia                 | *   | *               |                          |              | *           |                           |                |                |               |
| Indonesia                | *   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Laos                     | *   | *               |                          |              | *           |                           |                |                |               |
| Malaysia                 | *   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Myanmar                  | *   | *               |                          |              | *           |                           |                |                |               |
| Philippines              | *   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Thailand                 | *   | *               | *                        | *            | *           | *                         | *              | *              | *             |
| Vietnam                  | *   | *               |                          | *            |             | *                         |                |                |               |
| Mongolia                 |   |                 |                          |              |             |                           | *              | *              |               |
| Macao                    |   |                 |                          |              |             |                           | *              |                |               |
| Papua New Guinea         |   |                 |                          | *            |             |                           | *              |                |               |
| Australia, New Zealand   |   |                 | *                        | *            |             |                           | *              |                | *             |
| Nepal, Sri Lanka         |   |                 |                          |              |             | *                         | *              | *              |               |
| Bang., India, Iran, Pak. |   |                 |                          |              |             | *                         | *              |                |               |
| USA, Canada              |   |                 | *                        | *            |             |                           |                |                |               |
| Chile, Mexico, Peru      |   |                 |                          | *            |             |                           |                |                |               |
| Russia                   |   |                 |                          | *            |             |                           |                |                |               |
| EU-15                    |   |                 |                          |              |             | *                         |                |                |               |

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

(b) ASEM includes European Commission.

Source: Kuroda and Kawai (2002). Updated to include new information.

**Table 4. Interactions among Institutions and Arrangements in East Asia**

| FUNCTIONS                                       | ASEAN | ASEAN+3 | MFG | APEC | ASEM | ACD | SEANZA | SEACEN | EMEAP | PECC | ARCG | ACRAA | ADB | BIS |
|---|-------|---------|-----|------|------|-----|--------|--------|-------|------|------|-------|-----|-----|
| 1. Strengthen domestic institutions and markets |       |         |     | x    |      |     |        |        | x     |      | x    |       |     |     |
| 2. Develop regional arrangements and markets    |       |         |     |      |      |     |        |        |       |      |      |       |     |     |
| 2.1. Policy dialogue and surveillance           | x     | x       | x   |      | x    |     |        | x      |       |      |      |       |     |     |
| 2.2. Regional financial and capital markets     |       | x       |     | x    |      | x   |        |        | x     |      |      | x     |     |     |
| 2.3. Regional financial arrangements            | x     | x       |     |      |      |     |        |        |       |      |      |       |     |     |
| 2.4. Monetary policy and exchange rate systems  |       |         |     |      |      |     |        |        |       |      |      |       |     |     |
| 3. Capacity building                            | x     |         |     | x    | x    |     | x      | x      |       |      |      |       | x   | x   |
| 4. Research                                     | x     | x       |     | x    | x    |     |        | x      | x     | x    |      |       | x   |     |

|             | <b>Firm-Level Governance Index</b> | <b>Country-Level Indices</b> |                    |                     |
|-------------|------------------------------------|------------------------------|--------------------|---------------------|
|             | Mean                               | Legality                     | Shareholder Rights | Judicial Efficiency |
| Hong Kong   | 58.27                              | 19.09                        | 5.00               | 10.00               |
| Indonesia   | 37.81                              | 9.14                         | 2.00               | 2.50                |
| Malaysia    | 54.44                              | 16.65                        | 4.00               | 9.00                |
| Philippines | 40.72                              | 8.50                         | 3.00               | 4.75                |
| Singapore   | 65.34                              | 19.51                        | 4.00               | 10.00               |
| South Korea | 40.66                              | 14.21                        | 2.00               | 6.00                |
| Taiwan      | 53.45                              | 17.60                        | 3.00               | 6.75                |
| Thailand    | 53.54                              | 12.92                        | 2.00               | 3.25                |

Notes:

*Governance* is Credit Lyonnais Securities Asia's (CLSA) firm level corporate governance rankings. *Legality* is an index of legal and economic development constructed as a weighted average of Efficiency of the Judiciary, Rule of Law, Corruption, Risk of Expropriation and Risk of Contract Repudiation (Berkowitz, et. Al., 2002). *Shareholder Rights* is the sum of dummies identifying one-share/one-vote, proxy by mail, unblocked shares, cumulative vote/proportional representation, preemptive rights, oppressed minority, and percentage of shares needed to call an ESM (Shleifer, et. Al., 1999). *Judicial Efficiency* is from the International Country Risk Guide (2000).

Source: Klapper and Love (2002).

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

Source: de Brouwer and Corbett (2003).

| <b>Table 6. Indicators of Quality of the Financial Infrastructure</b> |                         |                       |                          |                           |               |                                 |
|---|-------------------------|-----------------------|--------------------------|---------------------------|---------------|---------------------------------|
| <b>(0 to 10 scale, higher is better)</b>                              |                         |                       |                          |                           |               |                                 |
|   | Delivery and Settlement | Benchmark Yield Curve | Public Issuance Modality | Private Issuance Modality | Average Score | Ranking of East Asian Countries |
| Hong Kong, China  | 8                       | 8                     | 8                        | 8                         | 8.0           | 1                               |
| Singapore   | 8                       | 8                     | 8                        | 8                         | 8.0           | 1                               |
| Taipei, China   | 8                       | 4                     | 8                        | 8                         | 7.0           | 2                               |
| Korea, Rep. of  | 6                       | 6                     | 8                        | 6                         | 6.5           | 3                               |
| Malaysia  | 6                       | 4                     | 6                        | 6                         | 5.5           | 4                               |
| Thailand  | 4                       | 4                     | 4                        | 4                         | 4.0           | 5                               |
| PRC   | 2                       | 0                     | 2                        | 0                         | 2.0           | 6                               |
| Philippines   | 2                       | 0                     | 4                        | 0                         | 1.5           | 7                               |
| Indonesia   | 2                       | 0                     | 2                        | 0                         | 1.0           | 8                               |
| US  | 10                      | 10                    | 10                       | 10                        | 10.0          |                                 |

Notes on Ranking Criteria:

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

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

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

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

Source: *Fabella and Madhur (2003)*.