Asian Regional Integration Initiatives: A Critical Review

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OUTLINE

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- II – Monetary Integration
- III – Financial Integration
- IV – Alternatives in Financing Structure
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I - Brief History of Asian Integration Initiatives

- 1967 - ASEAN established as political alliance
- 1992 – creation of ASEAN Free Trade Area
- 1997 – Asian Financial Crisis and proposal of Asian Monetary Fund opposed by US/IMF
- Dec 1997- first ASEAN+3 meeting to explore regional econ & fin cooperation
- Thereafter yearly ASEAN+3 Finance Ministers Meeting
- Feb 1998 – ASEAN Surveillance Process

Asian Integration History

- EMEAP (Executive Meeting of East Asia Pacific Central Banks) and establishment of Asian Bond Markets Initiative (ABMI) in 2001
- 2001 - ASEAN+3 Economic Review and Policy Dialogue
- 2010 – AMRO (ASEAN+3 Macroeconomic Research Organization)

II – Monetary Cooperation & Integration – Defensive Obj

- AFC – countries faced speculative attacks on currencies; failure of internat'l fin institutions to assist Asia
- 2000 – regional reserve pooling cooperation – Chiang Mai Initiative
- Assist countries with balance of payment difficulties
- Initial facility of BSA of $200m raised to $1 billion

Chiangmai Initiative

- Mar 2010 – CMI was multi-lateralized and fund size increased to $120 bn
- Weaknesses
  - Multi-lateralized process not facility
  - Fund size still too small
  - 80% of drawn facility tied to IMF
  - Not used by any member countries

Exchange Rate Coordination

- ABD floated ideas on Asian Currency or Monetary Unit made up of basket of currencies to:
  - Provide benchmark to monitor currencies
  - Signaling device on capital flows
  - Determining central parity for managed float system

Capital Flows

- Major challenge in monetary co-opn is managing volatile capital flows that caused AFC & financial & econ instab
- Individual countries have undertaken cap controls with diffnt degree of success, e.g. Malaysia, Thailand
- Without regional co-opn on cap controls, FX co-ordn and internat'l liquidity provision, countries resort to building FX reserves that are costly

Summary of Monetary Co-opn

- Efforts at Asian monetary cooperation at primitive stage
- Idea of moving fr dollar peg to basket peg in FX coordn is proper
- Chiang Mai Initiative with establn of AMRO are the most advanced & important parts of monetary coopn

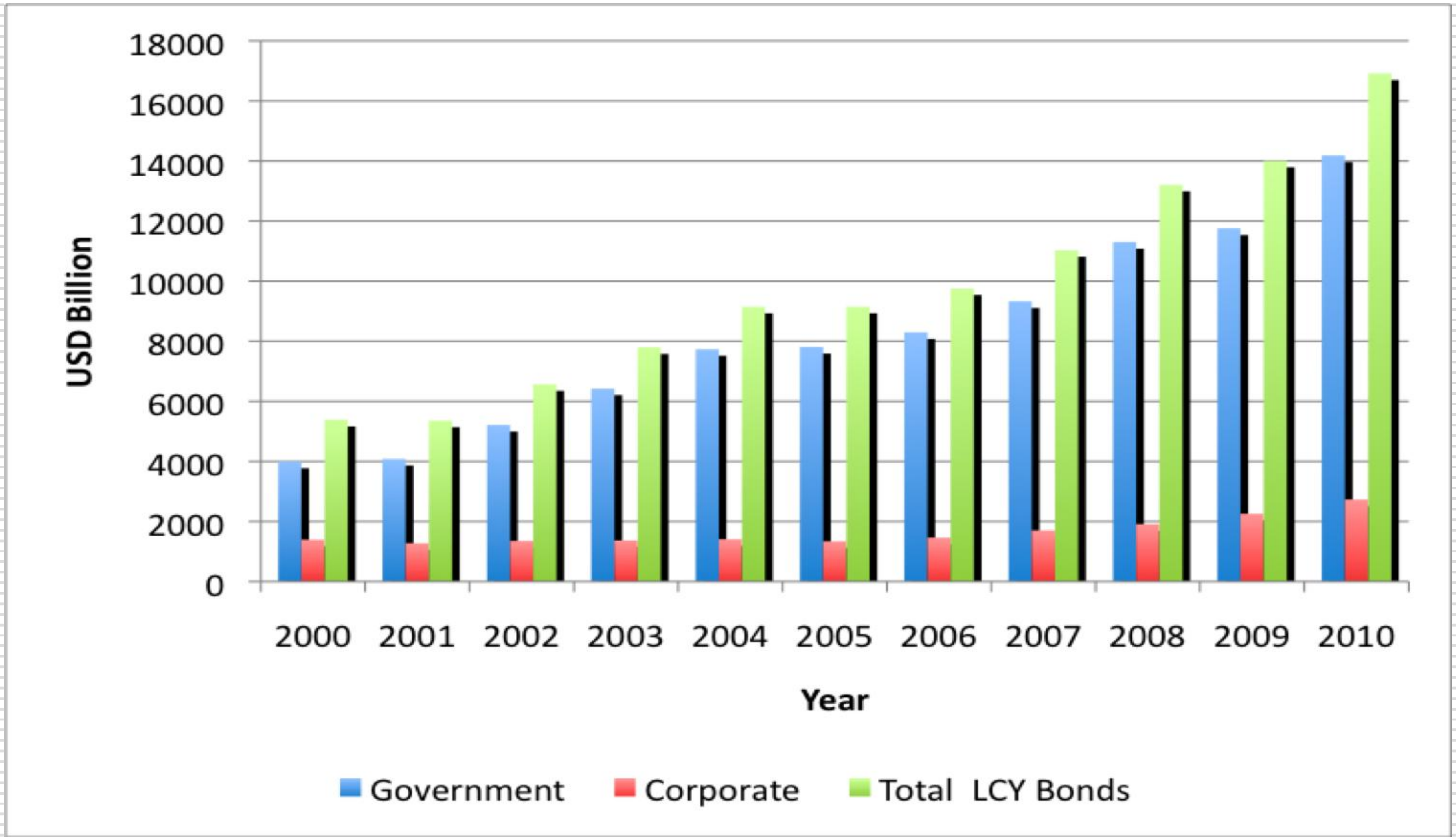
III – Financial Cooperation & Integration

- Development objectives :
  - Diversify dependence on bank finance
  - Minimize double mismatch
  - Recycle Asian savings from surplus to deficit economies
- Key to achieving the above is development of local currency bond market

Bond Markets Initiatives

- EMEAP launched first Asian Bond Fund in June 2003 for US$1 bn followed by ABF II in 2004 US$2 bn
- ASEAN+3 Fin Ministers 2003 endorsed Asian Bond Mkts Initiative with ADB taking lead role in technical studies on regional credit guarantee mechanism, rating system, clearing, settlement system, debt instruments

Bond Markets Performance – 8 East Asian countries 2000-2010



LCY Bond Markets

- LCY bond mkt tripled fr $5.4tr to $16tr btw 2000 and 2010
- 84% are govt bonds, 16% corporates
- Japan acct for 70% of total, China 18%, Korea 7% and rest 1% each
- Bond mkts as % of GDP – Japan 198%, Korea 110%, Msia 99%, Singapore 76%

Government Bond Markets

- China, Korea, Msia, Spore, Thailand large bond mkts due to sterilization of foreign reserves
- Msia, Spore – additional factor of compulsory savings schemes
- Thailand – legacy of govt bonds supporting bank bail outs and populist fiscal policies

Corporate Bond Markets (BM)

- Korea corporate BM -63% of GDP due to chaebol borrowing
- Malaysia corporate BM- large component is Islamic bond financing
- Singapore and Hong Kong are regional financial centres

Standard View of Bond Markets

"Financial integration, including the development of regional bond market, promotes more efficient allocation of resources, contributes to efficient price discovery… improves access to financial services, lowers cost for such services" (MAS, 2007)

2 critical issues of BM: (1) As Efficient Allocators of Resources

- Tobin-4 Meanings of Mkt Efficiency
  - Information-Arbitrage Efficiency
  - Arrow-Dubreau’s full insurance efficiency
  - Fundamental valuation efficiency
  - Functional or social efficiency
- Market efficient only in first sense – not possible to gain from trading on basis of available public information
- Fail in 2nd, 3rd and most miserably in 4th

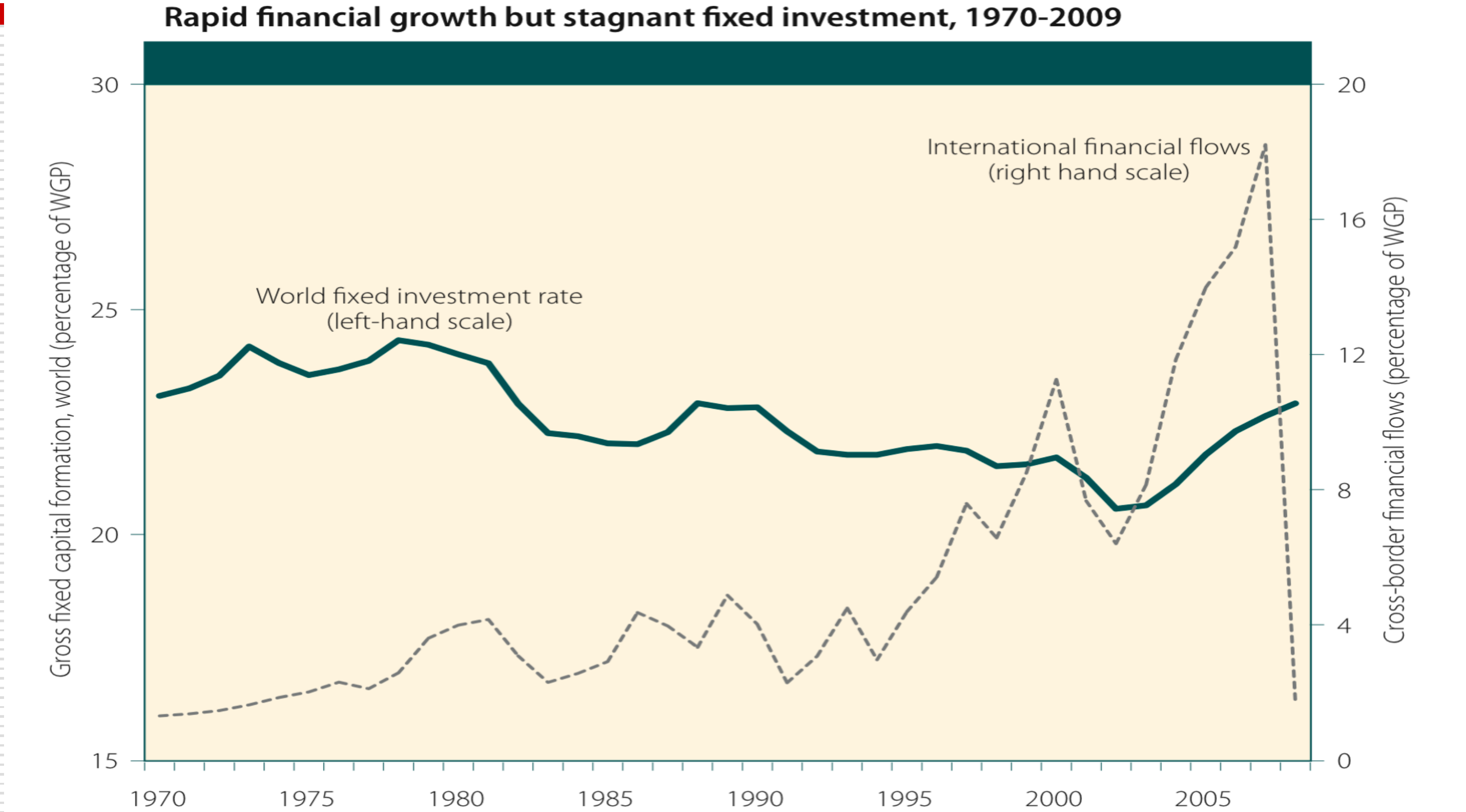
Social Efficiency

- UNCTAD (2009) – Financial mkts do decent job at evaluating information and processing transaction efficiently but do not contribute to long run growth.
- From regulators' perspective, the most relevant criterion **is social efficiency – contribution to stable, long-term economic growth**

Social Efficiency

- Asian Financial Crisis and Great Financial Crisis question the claims of mkt efficiency in terms of financial stability and long term growth
- Experience in financing in Indonesia
- Minsky thesis – financial markets becoming inherently more fragile and unstable moving from hedge to speculative and Ponzi financing

International Financial Flows & World Fixed Invsts 1970-2009



(2) Liquidity–Stability Trade Off

- Raison d'etre of cap mkts – liquidity
- ADB- common trading stds make it cheaper and faster for investors to **dip in and out of markets**
- Keynes – no such thing as liquidity for market as a whole. Liquidity is an individual investor concept not a system concept

Keynes on Liquidity

- "Of the maxims of orthodox finance, none is more anti-social than the fetish of liquidity…It forgets there is no such thing as liquidity of investment for the community as a whole. The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future.

Keynes on Liquidity

- “the actual, private object of the most skilled investment today is to “beat the gun”… to outwit the crowd, and to pass the bad, or deprecating, half crown to the other fellow.” (Keynes, 1936:155).

Liquidity vs Stability

- Problem is exacerbated where investments are from foreign sources
- Divergence btw benefits of liquidity to investors but macro-economic costs to recipient countries i/t of financial and economic instability as evidenced in AFC and in recent GFC

Keynes

- “With the development of organized investment markets, a new factor of great importance has entered in, which sometimes facilitates investment but **sometimes add greatly to the instability of the system”**

Alternatives in Financing Structure

- Direct financing – capital markets
- Indirect financing – bank financing
- Bond markets can mobilize large amt of funds but prone to instability esp if from foreign sources
- Funding thru long-term credit/development banks can also achieve objective of minimizing double mismatch

Japanese Experience before Financial Liberalization

- Japanese LT credit banks played vital role in rapid industrial development btw 1950s-1970s
- Segmented banking system with each type catering to diffnt mkt segments
- LT credit banks specialized in lending to targeted industries.
- Obj to achieve stable, long-term relation r/t ST transactional relation

Major study of Japanese banking system by Aoki & Patrick (1994)

- "In the economic and financial environment of high growth era, the main banking system …represented a successful solution to a key developmental problem: how to finance large industrial enterprise efficiently and effectively" (p.388)

Experiences of other countries

- In Germany, Korea, Taiwan, Brazil long term development banks played crucial role in industrial development
- BDNES (Brazil Development Bank) in 2010 - total assets of US$314 bn, US$ 96 bn loans disbursed, more than the World Bank
- Bank of North Dakota – state owned bank partners rather than compete

Bank of North Dakota

- With private banks – provide loan guarantees and fed fund lines
- Part of profits transferred to the state
- Over 15 years bank contribute more to state than oil tax revenue
- 2006-2010, assets rose from $2.3 bn to $4bn and made profits every year
- N Dakota 3% unemployment, budget surplus, lowest default rates

Conclusion

- In contrast to Anglo-American model of universal/invst banking that imploded, prudent banking institutions focused on long-term lending, avoid speculative instrument, not obsessed with maximizing rates of returns have done well over this recent crisis

Conclusion

- Bordo et al (2010) explain why Canadian banking system didn't suffer banking crises for over 200 years, while US banking system repeatedly did
- Costs and benefits with each type of financing; not mutually exclusive
- Type and mix of two systems depend on historical and current condition

Conclusion

- Primary role of finance – to serve the real economy, not to destabilize it
- Objective of development – to create stable, long-term, balanced growth, employment creation, equitable and welfare maximizing
- Means such as deep and liquid financial markets are confused for ends

Conclusion

- Capital markets good at moving capital freely across borders but come at great macro socio-economic costs – volatility, financial and economic instability
- More consideration should be given to other financing structures
- Study the experiences of such institutions

THANK YOU