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Comment on Professor Gordon de Brouwer's paper
Financial Markets, Institutions, and Integration in East Asia

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This paper achieves three objectives. First, it highlights a number of structural and performance problems in the key financial markets of East Asia. Second, it gives a critical assessment of the institutional diversities, strengths, and weakness of the local markets in East Asia. Third, it raises a few important policy issues on moving forward with regional integration of East Asian financial markets to bring them closer to the global best practices.

I agree with most of the analysis in this paper. In particular, the paper gives excellent assessment on the current problems in the Japanese financial system. Clearly, the weakening financial conditions in Japan may have implications on its role in shaping the future of Asia's financial landscape. A central conclusion I see from this paper is that the integration of regional financial markets in Asia is more likely to start from the more developed markets of similar institutional settings such as the markets in Asia's four most competitive economies: Singapore, Hong Kong SAR, Australia and New Zealand. In April 2002, these four economies have been ranked by the World Competitiveness Yearbook as 5th, 9th, 13th, and 19th most competitive economies respectively.

This point on Asian financial market integration deserves more discussion and attention by the policy-makers and researchers. The regional integration of trade in Asia has been going on for many years. With China's accession to the WTO, the trade system in Asia is pretty robust with low tariffs, low non-tariff barriers and rising trade volume. The regional integration of skills and technology is also going smoothly together with the rising foreign direct investment into China and other parts of Asia. The bottleneck of Asian economic development is clearly in the intermediation of its savings and investment. Asia's fragmented financial markets limited its ability to provide basic and normal functions of the capital markets: resource allocation, price discovery, risk management, and corporate governance.

About one third of the domestic savings in China and other Asian economies could not find productive uses and have to either sit in the banks or be lent to the government. The extremely low interest rate in Japan clearly encourages investment with low or no return. The fragmentation of the region's stock markets also implies that they have not benefited enough from economies of scale, scope, and integrated high liquidity. The price distortions in the Asian financial markets make it difficult, if not impossible, to use markets as one of the key discipline for corporate governance. The high non-performing loans in Asia's banking system and the fragility of their exchange regimes are still roots for future financial crisis.

Hence, Asia needs an efficient, integrated and robust regional financial market to play basic functions of modern financial markets. The key issue for regional financial integration is integrating towards which financial systems and practices. Will the giant Japanese system and practices change towards those in Singapore, Hong Kong SAR, Australia, and New Zealand? Or will the four smaller markets change towards the

Japanese model? The paper raised these questions but did not give a direct answer. Following the argument of the paper, the conclusion seems to be that if there will be any integration, Asian financial markets will integrate towards the internationally best systems and practices, which seems emerging gradually in the markets of the most competitive economies of Asia.

Japan and China are the largest economies in Asia. No Asian financial integration could success in the longer run without Japan and China. However, the paper and other evidences as re-organized in table 1 also suggested that today's Japan and China, ranked 30th and 31st respectively by the World Competitiveness Yearbook 2002, are not likely to be the model for Asia's financial market integration.

As the largest and most mature economy in Asia, Japan could provide Asia ready resources and financial weight for Asia's competition in the world markets. As the fastest growing economy with largest population and land in Asia, China is certainly another strong pillar for Asia's catching up with the West. A more integrated Asian market could benefits not just Asia but also Europe and America if the more integrated regional markets are efficient and competitive by global standards.

Hence, the core question is how to move ahead with regional financial market integration practically but firmly so as to create a win-win situation for all the major players, including Japan, China, Europe, and USA. This is difficult to achieve but deserves serious attention by the policy-makers in the region.

To think about how to move forward the regional financial integration, it is useful to put together a group of key and comparable indicators for Asian financial markets as shown in Table 1. Table 1 is re-organized from various tables in Professor Gordon de Brouwer's paper, materials from the World Competitiveness Yearbook 2002, and websites of various financial authorities in the region. They are listed in the order according to the ranking of competitiveness. I have included the USA as a benchmark economy.

It seems not an accident that the four most competitive economies in Asia (Singapore, Hong Kong SAR, Australia, and New Zealand) have shared many similarities. With similar historical and institutional backgrounds, such as the English Common Law legal tradition, they are all open economies with high productivity. Their banking systems and debt and equity markets are large and balanced with respect to their GDP. Their regulatory systems are mature and close to international standards. The four markets are geographically far way but could be linked together through the cyber networks at low costs given their excellent IT infrastructure. The relatively high turnover in foreign exchange and over-the-counter derivative markets and the large size of fund management industry in the four markets shows indirectly their low transaction costs and high competitiveness. They are presently the top-quality markets. They seem ready for regional integration. Their capacity and competitiveness should be used to eliminate the bottleneck of saving-investment intermediation in Asia.

The other markets in Asia, including those of Taiwan (ranked 24th), Malaysia (26th), Korea (27th), and China (31st) are very dynamic, catching up quickly with their unique

strengths. The major barriers to regional integration for this group of markets seem with their institutions, regulatory regimes, and opening of their economies.

As discussed clearly in the paper, Japan is unique in the regional financial integration because of its historical success in growth and development and present difficulties in the financial sector. Like China, Japan may need to spend more resources and efforts on restructuring its own enterprise and financial systems in the near future. A more efficient and more integrated financial markets led by the four smaller but most competitiveness economies in Asia would clearly make it easier for both China and Japan to concentrate on its own domestic restructuring. As China and Japan moves up the competitiveness ladders in the future, they will certainly become the leaders in the regional financial integration. But in the meantime, it is important for every Asian economy to realize that regional integration in Asian financial markets is likely to be a win-win case for all when the integration is moving towards the international best practices.

Table 1. Financial Markets in East Asia: Key Indicators

Unit	World	World	GDP	Productivity per Worker	Index on Quality of Financial Infrastructure	Bank Assets /GDP	Debt Securities /GDP	Equity Market Capitalization /GDP	Foreign	OTC
	Competitiveness	Competitiveness							Exchange	Derivatives
	Ranking	Score							Daily	Average
	2002	2002	2001	2001	2000	2001	2001	2001	2001	April 2001
			US\$ billion	US\$		%	%	%	%	%
USA	1	100.0	10,205.6	71,858.3	8.99	62.9	147.5	136.4	2.5	2.8
Singapore	5	81.1	85.6	44,934.3	7.58	243.5	40.5	135.2	118.0	84.7
HKSAR	9	77.8	161.9	52,605.2	7.75	215.3	27.9	312.6	41.4	32.1
Australia	14	74.1	367.2	55,218.2	9.06	262.6	43.6	102.2	14.2	13.8
New Zealand	19	66.5	49.1	43,297.7		187.7	26.9	36.3	8.1	6.9
Taiwan	24	61.3	282.2	52,911.3	7.50	262.3	19.8	103.7	1.4	0.6
Malaysia	26	59.7	87.5	22,273.3	6.55	208.2	93.5	136.0	0.1	1.0
Korea	27	56.8	422.2	39,617.1	6.73	232.9	67.3	46.1	2.4	0.9
Japan	30	54.3	4,143.8	52,779.0	8.67	139.2	153.1	54.6	3.5	3.2
China Mainland	31	52.2	1,159.1	7,375.3		160.0	28.4	45.4	0.0	0.0
Philippines	40	41.5	71.4	10,644.5	4.14	88.5	33.5	29.8	1.4	0.8
Indonesia	47	26.9	130.3	7,285.8	3.52	156.5	2.3	17.6	3.1	0.4

Source: World Competitiveness Yearbook 2002, IMD; Tables in the chapter; FIBV, BIS and websites of the central banks and ministries of finance in the region