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ASIAN DEVELOPMENT BANK
INSTITUTE
Kasumigaseki Bldg. 8F 3-2-5 Kasumigaseki
Chiyoda-ku, Tokyo 100-6008 Japan
Tel: 81 3 3593 5500, Fax: 81 3 3593 5571
Email: info@adbi.org http://www.adbi.org

2001 International Finance Seminar

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Executive Summary of Proceedings

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Key Messages

1 The Asian crisis unlike the conventional current account crisis is characterized as a capital account crisis, and countries with full capital account convertibility are more readily susceptible to such a crisis. Meanwhile, due to increased capital mobility and deepening global market integration, the policy options become narrower and capital account openness and financial market liberalization have led to the rapid reduction of policy independence.

2 The Asian financial crisis highlighted the importance of the corporate bond market, which can contribute to prevent another financial crisis by mitigating a double mismatch problem. Therefore, in a bid to design a new and balanced financial market structure in post-crisis Asia, underlying issues and arguments for concerns in the weak bond market should be addressed among others.

3 In addition to domestic efforts to address weaknesses of the financial sector, international financial architecture should be strengthened by promoting transparency, introducing common standards and codes in global finance and, last but not least, promoting private sector involvement. On top of that, the nature and role of key players such as preferred creditors and highly leveraged institutions (HLIs) in global finance should be understood correctly so that appropriate policy responses can be made for both crisis prevention and management.

4 In regional-level approach to prevent recurrence of another capital account crisis, regional financial arrangement and early warning system should allow for timely and effective collective response in the event of regional economic distress. Assessment of a better performing set of vulnerability variables indicating the emergence of crisis will help in predicting and in better understanding of the nature of crisis.

5 In individual country-level approach, one learns that government's policies for corporate and banking sector restructuring should be carefully planned, particularly in the containment stage of the crisis, carefully calculating financial costs of short-term measures, while institutionalizing effective financial safety net.

6 Electronic finance is a recent interesting development. As emerging markets are no strangers to the fast penetration of electronic finance, it is important for countries to prepare for the electronic revolution by fostering an enabling environment for e-finance and modifying conventional economic policies to take into account the changing landscape in the domestic and international finance.

Introduction

1. This capacity-building seminar titled "Seminar on International Finance: Challenges and Opportunities in Modern International Finance", was jointly organized and sponsored by the ADB Institute, the ADB and the Korea Institute for International Economic Policy (KIEP), from 17-21 September 2001, Seoul, Korea. The participants were middle- to senior-level government officials from nine Asian countries of the ADB. The main objective of the seminar was to enhance participants' understanding of various issues involved in the changing international financial environment and to provide them the opportunities to discuss methods of strengthening domestic and international financial sector through country-specific, regional and international approaches.

2. The seminar provided an in-depth learning experience for participants and a forum to discuss various conceptual and practical policy issues in financial reform and capital market development. Comprehensive presentations by eminent resource speakers from the academia and multilateral financial institutions provided the knowledge base for the seminar. Participants were also given the opportunity to present their own analysis and opinions about issues addressed during the seminar and to exchange views with one another and with resource speakers in interactive discussions.

3. In his welcoming remarks, **Dr. Kyungtae Lee, President, KIEP, Korea** expressed the hope that the seminar would provide an opportunity for participants to exchange views and to understand how international financial market works. He highlighted the fact that countries in the region must have experienced and learned country-specific, regional and global lessons in the process of responding to the crisis. The Asian crisis gave rise to the serious discussions on intra-regional economic cooperation because of the fact that recent international financial crisis did not just affect specific countries in the region but countries world wide. At the regional level, many Asian countries became aware of the need for regional financial cooperation, which can be helpful in effectively preventing and in better managing future crisis in the region. Despite some successes in international and regional cooperation, there is no assurance that the world will not suffer another financial crisis.

4. In addition, Lee said that the most recent critical economic shock is the terrorist attack on the US, which has hurt consumer confidence and can push the US economy into recession, possibly dragging the rest of the world with it. The attack has adverse effects on international financial markets, but in Asia more doubts are expressed because of the experience of economic slowdown that has already occurred before the 11 September event mainly due to the US economic sluggishness. He concluded that the important task is on how to prevent crisis from recurring and achieve sustained economic growth. One has learned from past experiences that a single country or organization alone cannot accomplish the task and also it is unrealistic to expect that the crisis-stricken countries can create a sound economic system within a short period of time, which took several decades of advanced economies to develop. But sound and advanced economic systems can be developed through continuous efforts at capacity-building, This seminar can contribute not only to prevent the recurrence of financial crisis but also build a resilient and sound financial system in the region.

5. In his opening remarks **Mr. Myoung-Ho Shin, Vice President, ADB** expressed his gratitude to the KIEP for organizing and co-sponsoring the seminar. He explained that international finance deals with capital flows and policy responses to increased capital mobility and market integration across countries and regions. The past few decades have experienced a dramatic surge in international capital flows, which have brought opportunities as well as risks. Shin pointed out three major issues of the changing global financial environment. First was the macroeconomic management because globalization has narrowed the options of macroeconomic policy and exchange rate management. Capital account openness and financial market liberalization have reduced the time lags and financial rigidities to allow more policy independence in the short run. As a result, it is no longer possible for policymakers to use simultaneously both policy instruments, the exchange rate and interest rate, unless they are ready to accept greater flexibility in the exchange rate. Choices of exchange rate regimes have thus become much more closely linked with monetary policy.

6. Second was the need for extensive second-generation reforms, which include strengthening the banking and capital markets, improving governance practices, and enhancing social protection measures. In a globalized financial market, developing countries cannot attract foreign capital inflows without their financial systems and corporate practices being closely scrutinized by foreign investors. Third was the need for a new international financial architecture. The Asian crisis emphasizes on the dire need of modernizing the international financial architecture to promote orderly capital flows and global economic stability. The role of regional initiatives in complementing global surveillance and private sector involvement in crisis prevention and resolution, and enforcing international codes and standards has been recognized and had some progress.

7. Shin concluded by describing two objectives of the seminar. One was to advance one's understanding of the key underlying factors that are changing the international financial environment, including the nature of international financial crises. The other is to deepen the understanding of the major initiatives in strengthening the international financial architecture as well as synergy among them. These initiatives include: (i) structural reforms and enhanced transparency in financial and corporate management at the country level; (ii) introduction of regional early warning systems and regional financial arrangements for crisis prevention and resolution at the regional level; and (iii) reform measures introduced or proposed by the BIS and the IMF at the global level.

8. After welcoming the participants and speakers of the seminar **Dr. Masaru Yoshitomi, Dean of the ADB Institute,** said that the Asian crisis is characterized as a capital account crisis, which is very different from the conventional current account crisis. The conventional current account crisis is often caused by very poor macroeconomic fundamentals. While in the case of Asian crisis, economic performance was not poor at all as was seen in inflation rate being very low, fiscal deficit non-existent, and domestic saving rate very high. Yoshitomi asked why then the Asian countries fell into the crisis. First, the capital inflows were very large, which were suddenly reversed and such fluctuations in capital account had adverse effects on the balance sheet of the domestic financial institutions and enterprises. The major characteristic of this crisis was the collapse of domestic demand due to an international liquidity and a domestic banking crisis. He said that the 'twin crisis' was caused by the so-called double mismatch problem of currency and maturity. It is difficult to avoid the double mismatch problem especially for emerging economies.

9. According to Yoshitomi, although one is not sure whether one will have this kind of crisis or not in future, the ADB Institute is seriously attempting to address the issues on how to avoid another capital account crisis and how to develop domestic capital markets in Asia in an environment where domestic banking system in most countries in the region is quite fragile and partly nationalized after the crisis. The ADB Institute is exerting its best efforts to determine the reasons on why it takes so long to develop capital markets, particularly corporate bond market. He explained that there are fundamental differences between the banking sector and the corporate bond market. One concerns the issue on who will bear the risks of investment or when loans are extended. In the case of banking sector, the banks bear the risks of bank loans but not necessarily depositors because depositors are protected by implicit and explicit insurance schemes. But in the case of bond market, the public investors have to bear the risks. The second difference is the nature of contract, that is, in the case of bank lending, it is very implicit and flexible as compared with corporate bond, which is very explicit in terms of interest rate, maturity and other conditions. Because of such differences, the regulatory framework will be very different. The ultimate objective of the regulation of the banking industry is to avoid systemic crisis and protect depositors. However, in the case of corporate bond market, the objective of regulation is to protect public investors' interest and not the intermediaries of the financial system.

10. To address these issues, the ADB Institute formulated policy recommendations under the **Asian Policy Forum** (APF). The APF was established in December 1999 with the participation of about 15 leading financial research institutions in the region. To-date, the APF has prepared the following seven proposals: (i) exchange rate regime suggested by Shin; (ii) the possibility or desirability of introducing capital control on short-term flows; (iii) ways of strengthening the banking system; (iv) developing capital markets including corporate bond market; (v) private sector investors' involvement; (vi) restrictions on holding domestic currency by nonresidents; and (vii) regional financial arrangement.

Challenges and Opportunities in Modern International Finance

11. **Dr. Masaru Yoshitomi and Dr. Sayuri Shirai, Visiting Scholar, ADB Institute** gave a joint presentation on **"How to Foster Bond Markets through Strengthening the Banking Industry".** Shirai pointed out that most of the Asian corporate bond markets are underdeveloped because the sizes of bond issues are small, liquidity is limited, maturity and investor base are small. According to her, the factors affecting the corporate bond markets are: (i) lack of benchmark bonds used for pricing; (ii) illiquid secondary markets; (iii) limited supply and demand; and (iv) inadequate information, legal and judicial infrastructure.

12. Shirai compared bank loans with bond finance by market participants and the different methods used to reduce agency problems. First, with regards to market participants, in the case of bank loans, the ultimate creditors are the depositors, while in the case of bonds, they are the public investors. She highlighted the fact that commercial banks play as risk bearers and intermediaries in the case of bank loans, while public investors and investment banks play the role of risk bearers and intermediaries in bond finance. Second, she stressed that different methods have to be adopted to reduce agency problems for bank loans and bond finance because in bank loans, the problem arises between banks and borrowers while in bond finance, it is between the issuers and the public investors. The advantages of bank's involvement in securities and related businesses are mainly efficiency gains achieved through minimizing the double mismatch problem and maintaining profitability. The efficiency gains due to reputation and informational advantages help to gain investors' confidence and achieve economies of scale, leading to lowering the underwriting costs. However, there are disadvantages as well. Higher default rates of average bank loans, conflict of interest between banks and investors, and higher switching costs are major disadvantages. Also, emergence of new risks such as unsold underwritten securities and counter-party risks could worsen the solvency of the banking sector as well.

13. Shirai spoke on the following three stages of financial structure prior to attainment of full bank dominance: (i) intermediate; (ii) full-fledged capital market; and (iii) banks. She asserted that the Asian countries are moving from the bank dominant stage to the intermediate financial structure stage and presented the appropriate regulatory frameworks for the intermediate financial structure stage for banks in Asia. To strengthen the banking sector in Asia, she suggested the adoption of three steps for action. The first calls for the reduction of government intervention in private bank businesses and for the elimination of government intervention in bailing out any bank in distress. The second calls for limiting the banks' connected lending by taking into account the quality of banks' own capital and for reducing the bank's equity holding from non-bank firms until banks improve their own internal risk management system. The third is to introduce prudential supervision and regulation to monitor the CAMEL (Capital Adequacy, Management, Earnings and Liquidity), and adopt other traditional indicators (capital adequacy ratio, liquidity ratio, non-performing loan (NPL) ratio) for monitoring banks' performance along-with market-based indicators (deposit rates, interest margins, interbank lending rates).

14. Yoshitomi presented thirteen policy recommendations on how to foster bond markets through strengthening the banking sector. His presentation could be divided into two parts. The first was on how to strengthen the banking industry, and the second on how to develop the capital and corporate bond markets. To enhance efficiency of the banking industry, he first defined the problems. He attributed the problems as due to directed and connected bank lending, weak monitoring and political interference. The first policy recommendation is to minimize government interference and enhance bank's own monitoring capability. To overcome the problems of capital ratios not being a good indicator, pro-cyclical movements of risk assessment, and limits of external risks assessment, his second policy recommendation provides insight as to how to strengthen prudential and supervisory regulations that would best suit the local financial environment. The third recommendation relates to the review of corporate structure of banks to avoid dominance of banks to cope with the problems of banks becoming too powerful, conflict of interests and systemic risks caused by banks' involvement in the securities business.

15. In sequencing capital market development, his fourth recommendation suggests the planning, prioritizing and pacing of capital markets development. The following actions are suggested to help achieve this development: (i) building consensus on the usefulness of bond markets amongst policymakers, governing authorities, market traders and investors; (ii) establishing government bond market for effective yield curve benchmarking; (iii) promoting primary market trading activities initially through statutory requirements on banks to hold bonds as liquid assets; (iv) promoting secondary market trading activities via regulatory framework, fiscal incentives and educational programs; (v) encouraging corporate bond market activities with policies to boost supply and stimulate demand; (vi) improving bond markets infrastructure, transparency, objectivity from external and internal credit rating assessment; (vii) establishing relevant financial markets to facilitate risk management strategies and further boost liquidity; (viii) gradually reducing statutory requirements and tax incentives once bond markets mature; and (ix) preparing for regional bond markets in the light of constraints in local bond markets.

16. To provide benchmark yield curves via government bond market, Yoshitomi suggested his fifth recommendation on regular issuance regardless of budgetary balance, and well-spaced maturities mix over a longer time horizon. His six recommendation relates to the stimulation of primary and secondary market activities with the set up of basic clearing and settlement systems. Yoshitomi's seventh recommendation is to adopt a comprehensive market-based pricing system. Finally, to overcome factors responsible for underdevelopment of corporate bond markets, he suggested as: (i) his eighth recommendation on encouraging demand for corporate bonds by promoting institutions and retail investors as well as banks with tax incentives during infancy period; (ii) his ninth recommendation for nurturing the supply of corporate bonds by establishing legal, regulatory and informational infrastructures; (iii) his tenth recommendation for establishing related financial markets such as forwards, interest rate swaps, options and futures; (iv) his eleventh recommendation for improving clearance and settlement systems to limit systemic risks; (v) his twelfth recommendation for encouraging transparency and objectivity of company information assisted by external and internal credit rating assessment; and (vi) his thirteenth recommendation for preparing cost/benefit analysis for an Asian regional bond markets, keeping in view the limited size of individual local bond markets.

17. In the **open discussion**, questions were asked about the regulatory coordination among the regulators when promoting corporate bond market development. Yoshitomi responded by giving an example of the Japanese case where authorities are highly cautious about the protection of public investors, resulting in very strict qualification that lasted until the late 1980s. He continued by explaining that there are only two purposes for these regulations: namely, one is to protect the public investors; and the other is to protect the banking industry.. The importance of the latter is declining with time but the former has remained a dilemma. He pointed out that as the market grows, there is a need to reduce protection on investors because he felt that the Asian capital market regulators are protecting public investors too much. He mentioned that such kind of protection would not result in encouraging public investors to make their own decisions and to take risk of investing in the corporate bond market.

18. **Mr. Charles Adams, Senior Economic Advisor, EDRC, ADB,** spoke on **"Issues on Bond Markets, and Global Development and Outlook".** He introduced key underlying issues and arguments regarding the development of local bond markets. One of the issues was to help avoid the problem of 'double mismatch.' It was clear that the structure of balance sheets particularly un-hedged foreign currency borrowing and short-term borrowing were the major factors of the crisis. There is an argument that the development of the local bond market will help in dealing with this. But there is a fundamental question about un-hedged foreign currency borrowing because the mismatch problem arises when certain emerging economies cannot borrow from abroad in their own currencies and foreigners are not willing to take exchange rate risks in the emerging market economies. This is the fundamental question that has been addressed in other parts of the world such as in Latin America where it was called the "original sin"—the notion that poor monetary policy experience leads to unwillingness on the part of international investors to absorb exchange rate risks.

19. The countries, which borrow short-term from foreign countries to fund longer-term domestic investment, are more prone to maturity mismatches. Therefore, if countries prefer long-term borrowing, they can avoid or at least reduce the mismatch vulnerability. He said that creating long-term domestic bond market in domestic currency is not a guaranteed policy instrument to avoid the maturity mismatch problem, as was demonstrated by the case of Mexico in 1994 and 1995 where it did not work. Therefore, the factor of risk management must be studied before adopting such a policy to deal with the maturity mismatch problem.

20. The second argument was about what happened in Asia in 1997 and 1998, where the financial crisis started from the banking system because banks are central in the Asian financial system, therefore, this financial crisis would clearly have large systemic problems. Thus there is a need to develop a local currency bond market to reduce or to avoid some of the risks because it is believed that bond market has lower systematic risks than the banking sector. The third argument was that the transparent and well-functioning bond market could help enhance the efficiency and transparency of the credit allocation process. The problem then is on how to develop this efficient and transparent market. The fourth argument was the popular Alan Greenspan argument of 'a spare tire', which explained that a country relying on only one segment of financial system like banks is clearly vulnerable, whereas, a country relying both on the banking system and the bond market, and perhaps on equity market as well, has a more diversified financial system. If one part of the financial system runs into difficulty, the "other spare tires" can keep things going. This is a "spare tire" argument but not about having a strong banking system.

21. Adams said that there is a need to strengthen corporate governance and transparency in developing a bond market in the Asian economies. Another argument was about the government's role in influencing credit allocation, which is large in most of the countries' banking sector, but it is believed that in case of the bond market, it is difficult for authorities to intervene. However, during the past several years, especially in Korea, this argument has not proven to be correct. In fact, the government could step in to provide the guarantees and to influence the allocation.

22. Adams then explained the prerequisites for development of bond market. First, most of the Asian economies at present are predominantly bank-based for two reasons: (i) the role of bank loans is significant because bank loans contribute a large part of the GDP; and (ii) the banks operate and control almost all capital market activities. Therefore, to shift the financial activity burden from banks and to reduce the systematic risks, there is a need to create a bond market, which would provide the "spare tire" scenario. Actually, this policy will work if the entity that is heavily involved in the bank loan business is the same for the bond market business as well. For this purpose, the immediate need is to strengthen and restructure the banking system to deal with the outstanding stock problems. Furthermore, it is important to strengthen the risk management, and to develop appropriate, strong supervisory regulatory structure within the banking system because bank operations are central to the payment system, and also, suppliers of assets and liabilities in the balance sheet.

23. The second prerequisite to develop bond market should be to allow foreign investors into the market. Liquidity is very important for giving incentives and creating a certain critical level of debt trading. Third, the HLIs also play an important role in the market to correct mis-pricing of the bonds and assets, therefore, one needs entities that can take positions. Fourth, regional cooperation and linkages are important where the liquidity of a country is small.

24. In the **open discussion**, one of the participants asked about the role of hedge funds in developing bond market and also how it should be regulated. Adams responded that hedge funds are regulated on the basis of where they are domiciled. This means that if they are domiciled in US jurisdiction, the regulation is focused on investor protection. Regulatory issues are actually 'investors' protection. If there is any regulation on hedge funds, it would be on the market rather than a particular player in the market. Hence, if hedge funds in the US take position of organized exchange, they are subjected to the same regulatory requirement as for any other player. Hedge funds play two roles: (i) in modern capital market, hedge funds are an important source of liquidity; and (ii) hedge funds, in an ideal situation, could be an important source of stability in the market because they do not face investor restraints that mutual funds have to contend with.

25. **Mr. James Lau Jr., Executive Director, Monetary Policy and Markets, Hong Kong Monetary Authority, Hong Kong, China** gave a presentation on **"Entry of Foreign Financial Institutions in Asian Economies and Its Implication".** He started by first introducing the four advantages of allowing entry of foreign financial institutions into local markets. The first relates to quality and range of financial services. Foreign participation may give rise to a more efficient financial sector because of the broader range and improved quality of financial services. Foreign competition will also put pressure on domestic financial firms to improve their productivity and services through exposure to new technologies and ideas. Presence of foreign financial institutions can also help to improve the cost/benefit assessment of infrastructure and other projects, thus leading to a more rational allocation of scarce resources.

26. The second advantage is the access to international capital. The foreign financial institutions bring in working capital. Many of the foreign financial institutions are often involved in loan syndication for financing projects in Asia by drawing investment capital around the world. Some Asian economies have grown to become regional centers for loan syndication. Foreign presence in Asia's financial sector also help to spur some of the domestic entities to step into the international market. The third advantage is the access to foreign human capital and management know-how. The management personnel, financial expertise and know-how from foreign organizations will help to improve the skills and standards in the domestic economy.

27. The last advantage is the improvement of the underlying prudential supervisory and legal framework for financial institutions. More interactions between the home regulatory authorities and foreign financial institutions will usually lead to the improvements in the supervisory approach such as disclosure rules and capital adequacy requirements. The entry of foreign entities will generally drive their economic and financial policies in the host country to move in line with international practices and standards. This will in turn help in reducing institutional and systemic risks.

28. Lau then described the current banking environment in Hong Kong, China. There has been a growing pressure for consolidation of Hong Kong's banking sector. Some bankers have attributed this to the removal of the interest rate rules in Hong Kong, China over the last fifteen months. There is no doubt that deregulation of interest rates was a catalyst but there are other factors also such as increased competition from domestic and global players, economies of scale, the need to make heavy investment in information and telecommunications technology, and an increased focus on maximizing profits and generating shareholder values, even in family-owned banks. One local factor affecting banking consolidation is the huge market in the People's Republic of China (PRC), which is attracting many banks in Hong Kong, China. But the bank that wants to establish a branch in the PRC must have assets worth $20 billion to be eligible. The Hong Kong Monetary Authority (HKMA) encourages the banking sector to consolidate, but also it does not force healthy banks to merge or be acquired against their will.

29. Against this banking environment, Hong Kong, China has undertaken a series of banking sector reforms. First, the condition of "one building" was relaxed. It was because overseas-incorporated banks, which have been licensed there since 1978, were required to maintain offices in only one building because of the customers' access. Second, the deposit insurance scheme has been developed. Some key findings related to the functioning and responsibilities of deposit insurers were: (i) deposit insurance contributes to the stability of a country's financial system and protects depositors; (ii) it is preferable to implicit protection or blanket guarantees; (iii) the insurance system must be properly designed, well implemented and well understood by the public in order to be credible and to limit the risk of moral hazard; and (iv) a deposit insurance system cannot stand alone; it must be part of a well-designed financial safety-net. The third measure involves the establishment and development of credit reference agencies. Credit Information Service Ltd. (CIS) was set up in 1982 to compile negative credit data such as data relating to an individual's failure to meet one's financial obligations.

30. Lau then analyzed the reasons for reckless or unregulated internationalization. The first reason he explained is that the ability of domestic regulators to monitor a more complex financial system might be limited. Second, foreign entries may improve the profitability of the domestic institutions, even though some might consider that such institutions are there to serve "international interests". Third, foreign financial institutions have, certainly, some regulatory advantages over local institutions, such as the latter needs some time to familiarize and develop their managerial skills to meet the regulatory requirements. Fourth, there is a traditional infant industry argument for protection of the local industry.

31. In the **open discussion**, one of the participants asked if Hong Kong, China faces anti-competition behavior because of increasing mergers and acquisitions, then what measures should be taken to spur the competition. Lau responded that in Hong Kong, China the local banks are family-run, therefore, they are conservative and healthy—capital adequacy ratio sometimes is as high as 16 per cent. They are highly capitalized and most of them have their own clients. So there exists a risk of loosing the big part of their business because of the reliance on a certain number of clients. Therefore, the banks currently are networking themselves instead of consolidating to cope with changes such as e-financing.

Managing the Globalization of Finance —International Initiatives

32. **Mr. Charles Adams,** made a second presentation on **"Efforts to Strengthen the Architecture of International Financial System after the Crisis".** He spoke on progress achieved on the new international financial architecture program and the extent the program would address the concerns of the Asian countries after the crisis. International financial architecture covers a whole spectrum of markets, institutions and practices that govern the economic relationships among governments, businesses and individuals within and across countries. The driving force to strengthen the international financial architecture is the growing integration and globalization of markets, and the unfortunate financial crisis during 1997 and 1998. The program for strengthening the international financial architecture has three major elements, namely to: (i) reduce volatility at the global and country level; (ii) enhance economies' resilience to shocks; and (iii) take interest in managing financial crisis in a better way. The basic argument here is that globalization in terms of trade, capital flows, and others brings many advantages. But, at the same time, the system has been imposing excessive risks and costs on emerging market countries.

33. The objective of the program is to enhance transparency not only in government and international financial institutions, but also in private financial firms and markets. The following are the two reasons for too much attention being given to transparency: (i) the recognition that private market needs information if they are going to price and allocate resources correctly; and (ii) the lack of transparency in some central banks before and during the Asian crisis had led to outcomes where market dynamics were much less favorable than what should have been the case.

34. Regarding the transparency, the IMF did two important things: (i) it has become a more transparent organization itself in its own operations, procedures and decision-making, which is clear from its website where all information about its functions is now available; and (ii) the IMF has been supporting a number of important initiatives to enhance transparency such as GDDS (General Data Dissemination Standard) and SDDS (Special Data Dissemination Standard) are basically intended to provide transparency of member countries, and PINs (Press Information Notices) are released quite commonly now. At the same time, the IMF is encouraging members to publicly release the staff report that are prepared for Article IV. The IMF, being a cooperative international organization, is not pressurizing members to take such measures because it recognizes that each country has its own policies on the level of information to disclose. Instead, the IMF is trying to take such steps, which can allow its member countries to take benefit from increased transparency. The incentives are market-orientation for increased transparency because markets will penalize or reward for the level of transparency a country has. It is hoped that, in future, transparency, not only in the public sector but also in private financial firms, will improve.

35. To overcome the crisis, the transparency in private firms in Asian countries was the main concern of many governments. Adams made a final point on the subject of transparency that many people believe relates to the importance of transparency, but there are a number of people who question whether enhanced transparency can actually address the concerns to avoid or overcome the crisis. Adams explained that in fact, the Asian crisis would have avoided some of the negative shocks through transparency. However, it should not be overstated that, even in most transparent markets such as the US market, speculations have thrived. The transparency is rather a key building block for the whole international financial architecture.

36. The second element of strengthening the international financial architecture is the standards and codes. There has been a continuous effort to develop various international standards and codes. The IMF has actually been assigned an important role to assess the compliance of standards and codes through ROSC (Report on Standards Compliance). There has been a debate within the IMF on whether the countries' compliance to standards and codes should be a pre-condition for their access to use the IMF resources or not. But finally the decision was not to formally link the use of resources to the observance of standards and codes. Instead, the market creation was the appropriate incentive rather than tie the IMF resources.

37. The third area of concern in strengthening the international financial architecture is the effort to encourage countries to strengthen their financial system, particularly the banking system. During the last 10-20 years, many of the IMF member countries are having problems in the banking sector. The banking sector problems, not only, occur in emerging market economies but also in many of the IMF's advanced and second largest economies in the world as well, currently, several are facing severe economic problems.

38. Another element for strengthening the international financial architecture is the private sector involvement (PSI). The financial crisis across countries has been very difficult to deal with for two reasons: (i) the sovereign country may have problems servicing its external debt; and (ii) as shown in the Asian crisis, there needs to be a better mechanism than the high interest rate defenses to stop the sharp pull-back of creditors. High interest rate defenses may work but it tends to be very expensive in terms of output cost. The motivation that is driving the PSI initiative is the attempt to make PSI easier at the international level for debt restructuring as it is at the national level. But it turned out to be awfully difficult because of sovereignty problems, and difficulty of replicating all the elements of the domestic procedure. There are two schools of thought to deal with the PSI: (i) the Europeans and Japanese view that one should go toward a more formalized arrangement for restructuring, rescheduling and dealing with the international debt problem; and (ii) other is the U.S. view that one should articulate general principles but utilize a case-by-case approach for PSI. This is one area of architecture that is most important but ironically one has made the least progress.

39. In the **open discussion**, one participant commented that emerging market economies should adopt the Basel Accord, which is to adopt the international standards and codes progressively to conform to the situation of the country. Adam responded to the question on whether transparency and globalization have been over-advocated that the transparency can get too far but the enhancement of transparency can generally help to increase the benefit. To respond to the second question about unbalanced globalization, Adams agreed that the globalization is unbalanced but also pointed out that opening up is as important as balanced globalization and one should equally reinforce it.

40. One of the participants asked about the appropriate exchange rate regime. Adams responded that 'floating plus' regime like inflation targeting, was introduced during last 2-3 years but there is a tendency in Asia to move away from the soft peg. However, he doubted whether this would work or not because there existed a currency mismatch problem in the financial sector.

41. **Mr. Ying Qian, Senior Financial Economist, Financial Sector and Industry Division, Infrastructure, Energy and Financial Sectors Department (East), ADB,** gave a presentation on **"Basel Initiatives Toward a Sound Financial Architecture: Implications for Developing Asia".** He first assessed the merits and weaknesses of the New Accord. According to him, the merits are: (i) providing refinements for risk weighting; (ii) recognition of credit risk mitigation such as providing collaterals and guarantees; and (iii) introduction of supervisory role and market discipline. The weaknesses are: (i) the New Accord is too complex for most of the banking sectors in developing countries; (ii) large reliance on judgment may soften the standards; (iii) potentially excessive reliance on external rating agencies; and (iv) potentially high liabilities on supervisors if the approved bank fails. Qian also pointed out that the prudent banks with good quality credit counter-parties, first-class control systems, high-ranked private sector borrowers and sovereignties outside the OECD, and taxpayers should benefit from the New Accord.

42. Qian then illustrated the implications of the New Basel Accord for developing Asia. These are: (i) higher risk weights for certain types of assets would lower the capital adequacy ratio and demand more capital from banks to restore it to the 8 per cent norm; (ii) over-reliance on the rating of the external credit rating agencies (CRA) in the standardized approach may not be prudent enough even though the CRA ratings are based on best judgments; (iii) certain risk weights are still subject to debate because changes in CRA ratings could lead to large changes in the capital charge due to large change in risk weightings from relatively small change in rating; and (iv) there may be consistency programs associated with the Internal Ratings Based (IRB) approach in judging one bank's ratings against the other in the same country, among the banks in several countries, and then comparing IRB ratings with the standardized approach, for example, one study has shown that bank's internal ratings can be more pro-cyclical than external ratings, which can aggravate economic cycles because loan standards are relaxed during boom times and tightened during recessions; (v) bank supervisors have to make many judgments but the subjectivity often creates tension between less experienced supervisors and senior-level policymakers; (vi) the IRB approach in determining the adequate capital under the Pillar One may result in the banks of the emerging market economies having to pressurize their supervisors to use the approach when the supervisor may not yet be able to properly determine the right choice; (vii) many developing Asian economies are lacking competent and independent external credit assessment institutions, which are crucial in ratings of corporate borrowers in the risk weightings under the standardized approach; (viii) it is possible that supervisors will face a new set of pressures from their own influential banks, as well as the Financial Stability Assessment Program (FSAP) type of surveillance because such pressures are supposed to increase when implementation will be adopted in 2004; (ix) the Pillar Two of the New Accord needs extensive judgment from supervisors, therefore, there is a possibility that many supervisors in the developing Asian economies may not feel comfortable and the degree of judgment required will become difficult for supervisory authorities where there is a high personnel turnover of both senior and junior level staff; and (x) the supervisors in Asia, who are trying to improve the standards of best practices, should concentrate on enhancement, gaining experience, undergoing training and improving their judgment. The banking community and supervisory authorities will require more lead time before adopting the New Accord.

43. Qian then suggested the following measures to cope with the New Basel Accord: (i) training is a key element in improving banking supervision practices as well as dialogue among senior bank supervisors; (ii) in the developing countries in Asia where the banking environment is at relatively high risk, the supervisory process needs to be strong enough to ensure that a bank's capital position not only meets the minimum levels of capital requirement but also is prudent in managing its overall risk profile and strategy; (iii) to minimize the risk of systemic banking crisis, supervisors should take account of a bank's potential to trigger system instability; (iv) in the developing Asian economies, true capital position and the cost of rescuing the financial sector must remain hidden for sometime due to inadequate capital calculations compounded by weak supervisory practices and public sector's willingness to tolerate or support undercapitalized banks, in such circumstances, good supervisory practice is more important than merely quantitative calculations; and (v) regarding market discipline, often in developing Asian markets, disclosure and transparency are quite unreliable due to lack of data, insufficient legal mandates for financial disclosure and unduly restrictive secrecy rules.

44. Qian concluded that success in effective supervision depends on: (i) sound and sustainable macro-economic policies; (ii) level and sophistication of overall financial sector development and effective market discipline; (iii) experience within the supervisory authority; (iv) continuity and devotion of senior level policymakers to their work to achieve a high level of bank soundness; (v) a comprehensive legal framework for the financial sector including procedures for efficient resolution of problems; and (vi) accounting based on international standards to their clients.

45. In the **open discussion**, two points were raised regarding capital adequacy ratio. One was on whether the capital is real and the other was on if the accounting is not right, then the numbers could be meaningless. Qian agreed that the procedure of how the numbers were calculated is also important. One of the participants pointed out that some of the international standard-setting bodies lack broad participation of the developing countries. Adams responded to this question and agreed that the Basel Group is not completely democratic according to the membership but he added that the Basel Group usually asks the input from all over the world to have a consensus on some certain issues.

46. **Mr. Charles Adams** began his third presentation on **"Addressing the Systemic and Market Dynamic Concerns for Highly Leverages Institutions"** by introducing that a study group was launched during the Financial Stability Forum (FSF) to assess the HLIs' impact on financial destabilization and implications for market integrity using various measures. The study group conducted six case studies, one each in Australia; Hong Kong, China; Malaysia; New Zealand; Singapore; and South Africa. In the impact assessment of the HLIs, the study group found a big gap between US, who has actively participated in HLI activities and the Asian governments, which strongly insist that the HLIs are responsible for destabilization in the Asian financial markets. Therefore, the study group has reached a wide definition of HLIs that include the proprietary trading desks of regulated commercial and investment banks as well as hedge funds. However, in case of the fatal consequences of the HLI activities during the crisis, 6-surveyed economies have handed out different reports on the significant role of HLIs in their markets and suggested different approaches in terms of aggressiveness.

47. Two aspects of HLI activities were discussed. First, in terms of size and concentration, during the survey some market participants were asked to describe the hedge funds owing to their size and concentration. Indeed, HLIs in all the 6 economies claimed a large share in terms of short positions in the currency market because the big players are reportedly to be slow to build up their positions and create unrest in the market for others. This provides the basis for the market participants' apprehension that it would become difficult for the big players to manipulate the market calling for preventive measures against so-called stealth positions of the hedge funds and HLIs. While the impact of the reported aggressive trading by HLIs was difficult to assess but heavy trading by the HLIs was observed by some market participants during the illiquid and lunch hours in the home market, or during quiet periods between the major centers' active trading times, to make attempts to move the rates on short equity and currency positions.

48. To assess the impact of the large and concentrated HLIs on market dynamics and market integrity, Adams explained that there are both short-term and long-term influences of the HLIs. Over a long-term, economic fundamentals are assumed to be the ultimate determinants of real exchange rates and asset prices but over a short-term, it is likely that exchange rates are strongly dependent on the micro financial structure of the market such as grouping, feedback, hedging and the key market players. The markets will be one-sided with short-run factors if market liquidity is low even though the impact of short-term factors will spread over the market.

49. Adams concluded that the HLIs are acceptable but that there are some concerns about specific market circumstances. Some of the market participants believe that still the HLIs are involved in market manipulation and double play, which is to move the market price from the equilibrium level to earn profit. He said that the manipulation problem could be addressed

through the organized exchanges among major countries over a shared definition of market manipulations. There are three underlying difficulties in addressing manipulation problem: (i) in identifying the motives; (ii) in assessing the equilibrium price and proving how much fluctuations made from this level; and (iii) in indicating the intention of profit-earning.

50. The following recommendations have been made based on the findings of the studies: (i) preparation of guidelines for foreign exchange trading because voluntary guidelines, though lacking a binding force, can contribute to disseminating judgment and evaluation on trading behaviors; guidelines must be made available on the website for the private financial sector as well; (ii) enhanced HLI disclosure; and (iii) enhanced market transparency.

51. In the **open discussion**, on a query about recently rising pessimism on the future of hedge funds, Adams replied that hedge funds are potentially very beneficial because a lot of firms in the financial market are tracking benchmarks and improving herding behavior. On the other hand, hedge funds, which are available to large and important investors, do not track the same benchmarks and therefore, face some restrictions to establish short positions. Based on this, they can be a stabilizing factor taking opposite direction when the market is moving irrationally in one direction.

52. When asked about the feasibility of a regulatory system governing hedge funds, Adams suggested reviewing the rationale of general financial regulation. There can be three arguments to advocate the establishment of the regulatory system: (i) protection of investors; (ii) enhanced market integrity; and (iii) prevention of systemic risk. There is some criticism on such suggestions. This relates to: (i) the justification to protect the large hedge funds' investors under the new regulatory system, (ii) it being unfair to single out one particular group in the market and regulate it; and (iii) the long-term hedge funds posing systemic risks but in practice imposing regulation on them is quite difficult. But Adams considered the regulatory system as a possibility to strengthen bank dealings with hedge funds because banks provide credits for them.

53. A participant raised the question about the problems related with collecting data on the hedge funds industry. In his response, Adams said that templates have been drawn in the FSF and also some other committees are working on the issue of the HLI disclosure. He predicted that hedge funds would be more open in the future because it is evident that the major banks have recently started more funding to hedge funds and began to demand greater information disclosure from their investors.

54. **Dr. Eisuke Suzuki, Deputy General Counsel, ADB** gave a presentation on **"Preferred Creditor Status of International Financial Institutions (IFIs)".** He discussed 4 major aspects on the preferred creditor status, namely, (i) how and why a preferred creditor's status is necessary; (ii) who determines the creditor's status; (iii) who is eligible; and (iv) what are the future prospects of a preferred creditor.

55. The preferred creditor status is defined as the creditor from one of the sovereign states who may be given priority over individual or group of investors in the settlement of external debt. The matter of preferred creditor status arises during debt rescheduling, when a sovereign debtor claims default, all the creditors and their claims cannot be treated equally therefore, they need some criteria in determining the inclusion or exclusion of debt from the rescheduling exercise. The status of international financial institutions (IFIs) as the preferred creditors enables them to create cooperative institutions in which economic rehabilitation of sovereign debtors is imposed to mitigate the adverse impact on the market.

56. Suzuki said that the uniqueness of the preferred creditor status is the benefits an IFI (as preferred creditor) can bring to the international financial market. IFIs are revolving funds that are raised based on high credit ratings. Furthermore, the IFIs will be eligible for high rate and provision of cheaper loans only after the repayment of previous loans. Therefore, this is all participants' interest to entitle the IFIs as the preferred creditor status and allowing them to access cheaper funds.

57. In the **open discussion**, Adams suggested an analogy to domestic bankruptcy law. He stressed that the preferred creditor status is not just a privileged international institution but it is an argument for the functioning to keep a financially challenged entity and to help it restructured. The preferred creditor status is gaining more attention in recent years, as government-issued bonds are becoming a popular investment. Due to the widespread potential distribution of bond ownership, governments have to seek agreement with bond bearers in a similar form of collective debt negotiations in the face of repayment problems, and in this process the international financial organizations as preferred creditors are expected to play a key role under the circumstances.

58. A participant raised an issue about the purpose of the IFIs and argued that debt rescheduling is the way to support developing countries' economic growth.

Managing the Globalization of Finance —Regional Perspectives

59. **Dr. Doo Yong Yang, Research Fellow, KIEP,** began his presentation on the **"Regional Financial Arrangements—Progress and Future Prospects".** The presentation covers three aspects, namely, the rationale for regional financial arrangement, the desirable form of monetary cooperation in Asia, and a critical overview of previous experiences. Three motives of regional financial cooperation were cited: (i) since the Asian financial crisis in 1997/98, the crisis-affected countries have learned that crisis does not occur in a single country alone but could spread to other countries through the "contagion effect"; (ii) the Asian crisis was seen as due to imperfect and irrational behavior of the international financial market; and (iii) the Asian markets are different from other international financial markets.

60. The literature on the creation of international financial architecture aimed at crisis prevention is widely available. The general findings of most of the literature on crisis prevention are: (i) crisis prevention scheme includes reinforcement of crisis surveillance function, regulation of short-term capital flows, choice of exchange rate regime, for example, choice between floating or fixed exchange rates, monitoring of the HLIs such as hedge funds and imposition of restrictions on the supply side; and (ii) the IFIs are to play an increased role while the private sector should be involved in implementing the measures to resolve the crisis.

61. The regional-level financial architecture in Asia has a long history. In 1997, ASEAN members held a meeting to promote monetary cooperation through the Asian Swap Management (ASM). In this approach, members are to contribute a certain portion of their shares based on the equal partnership principle but often face problems due to limited resources. A recent development in the regional financial cooperation is the 2000 May Chiang Mai Initiative, in which it was proposed to establish a bilateral currency swap arrangement, develop joint activities and allow for quick disbursement of currency swaps, establish a decision-making process and create a monitoring and surveillance system. Another significant attempt to build a regional financial architecture was the Japanese proposal to create an Asian Monetary Fund (AMF) in recognition of the need to enhance the functions of the global lender of last resort. However, these ideas were strongly opposed by some countries on grounds that it could create moral hazard problems.

62. One lesson that is learned from the past abortive attempt to strengthen the regional financial architecture is that the Big Bang approach is not desirable. Analyzing through the unsuccessful cases of the past, Yang proposed a two-step approach comprising establishment of (i) regional liquidity facilities under the Chang Mai Initiative; and (ii) exchange rate coordination mechanism. Still, there are more questions to be answered and proposals to be reviewed. For example, it is difficult to define the optimal currency exchange regime and to evaluate the proposals of the Asian countries moving away from the dollar-pegged exchange rates to the weighted exchange rate regimes or the institutionalization of dollar blocs. In his concluding remarks, Yang stressed that the important question is on whether all the good proposals can be implemented and accomplished in reality. Later Adams added that there are three discussions going on at present: (i) how to deepen the financial and monetary cooperation in the region; (ii) whether IMF should take a complementary or supplementary role in the region; and (iii) whether all the ideas are feasible.

63. In the **open discussion**, one of the participants asked about the recent developments and progress in the regional financial cooperation. Another question asked was about the rationale for Asian countries to create an integrated regional economy. Another participant inquired on the possible reasons for a relatively low level of intra-regional trade in Asia as compared with the European Union (EU). There were some discussions on the IMF's policy recommendations, and some participants raised the question on the need to allow the IMF to have more differentiated conditionalities, depending on the nature of the financial crisis.

64. Regarding the prospects for strong economic integration in Asia, Yang noted that questions have been raised as to whether Asia could reverse the two-step sequential approach to reinforce regional integration as already attempted successfully in Europe, which is carrying out financial and monetary integration after the creation of a preferential trading bloc. He noted that there are already on-going efforts to promote trade and investment in the framework of APEC and to strengthen regional financial cooperation through the Chiang Mai Initiatives. He envisioned that promotion of trade and investment among the Asian countries would go parallel to an accelerated regional financial cooperation.

65. Adams made valuable comments over the regional financial integration in the Asia. He expressed guarded optimism over the continued evolution of the regional financial architecture in Asia such as the ASEAN+3 initiative, which survives through the unsuccessful proposals to build the regional financial architecture in the region. One of the success factors of the ASEAN+3, he stressed, was attributed to the political support for the realization of the regional financial cooperation schemes, while the AMF and the Asian BIS were never embodied because of the strong opposition from some countries. He advised that promotion of regional economic cooperation should not be misled to isolationist Asia but rather serve the initiative of the region's continued integration into the global economy.

66. Participants further exchanged views and knowledge on the latest developments in the regional financial arrangement. Since the doomed attempt to set up the AMF in the light of "competition of conditionalities", the Asian countries continued to move on to settle their minor regional financial frameworks including currency swap schemes. As a result, participants noted that the Asian countries now have a three-layered defense system to fight against future financial crisis. A participant defined the three-layered defense system as the IMF, the ASEAN+3 initiative and the on-going minor framework groups.

67. Despite the efforts to have more comprehensive regional cooperation to strengthen the Asian financial structure, concerns have been expressed on the existing IMF-led bailout programs and alternative choices to better defend Asia against future financial difficulties may have to be considered. There has been a difference of opinion over the real cause (current or capital account) of the Asian financial crisis of 1997/98, resulting in concerns being expressed on the possible adoption of more differentiated conditionalities of the IMF. Adams said that the difficulty to respond to such a crisis is to reach on a consensus about the causes.

68. **Dr. John Hawkins, Senior Economist, Bank for International Settlements (BIS)** delivered a presentation on **"Early Warning Systems for Financial Vulnerability in Emerging Economies".** Hawkins pointed out that one lesson that has been learned from the Asian financial crisis is that the process of recovery from such a crisis is quite costly and burdensome. This being the case, taking effective preventive measures to avoid such a crisis is paramount.

69. He reviewed the academic studies on the operation of early warning systems and identified users of it. He highlighted the practical use of those indicators in the BIS and explained how BIS international banking data can be a useful component of the system for warnings and to predict problems. He explained that the academic studies have revealed the following three types of approaches could be considered: (i) qualitative approach, which is the use of data and information to draw graphs to compare the behavior of the economic variables in normal as well as in crisis mode not only within the country but also between the countries with and without the crisis; (ii) econometric approach, in which researchers use regression analysis to identify independent or composite indicators of crisis and sometimes use logit and probit models to test whether indicators are associated with a higher probability of a financial crisis; and (iii) non-parametric estimation approach, which is applied to evaluate the usefulness of a number of different variables in signaling the pending or potential crisis by looking at the threshold values.

70. Hawkins suggested that a study by Kamisky *et al.* 1998 is a good review of literature on the topic of the currency crisis and indicators to predict such a crisis. In this study, the author reviewed 28 studies on such a topic and tested 105 possible indicators that might predict the crisis and singled out 43 significant ones. The study concluded that each study's results depended on whether it was carried out pre- or post-crisis period such as external debt had never been tested before but now considered to be a significant variable because prior to 1997, many studies were focused on the Latin American crisis in which public sector accounts were important problems.

71. About the nature of financial crisis, one can easily distinguish between banking- or currency-related. The banking system crisis occurs when the banks cease to fulfill their role, on the other hand a currency crisis is attributed to a large depreciation of currency. Both are interrelated, in fact there is strong evidence that banking crisis leads to currency crisis but there is some ambiguous evidence also that it is the other way around. In most of the studies, the measurement problem has been pointed out, particularly in defining the crisis. The results of these studies on the warning indicators can be useful for governments to avoid a potential crisis. Despite the importance of the studies to indicate warning, it is difficult to establish a benchmark for real exchange rate, which is one of the exemplary early warning indicators because historical study may not be useful in predicting crisis.

72. Another important early warning indicator is the international reserve, but one has found that some of the international reserve data is over-reported. Signing agreements between countries to disclose information on more standardized basis about their international reserves can overcome this problem. Hawkins mentioned that output gap can be an indicator if GDP level is measured by the method of extrapolation but it is difficult to know what is the chain growth rate. Indicators to assess the banking system also have problems in measurement. Conceptually the bank's capital asset and NPL ratios are very important variables but one often encounters measurement problems because different countries have their own definition, accounting methods and auditing standards. When the banks transfer their bad loans to the asset management companies (AMC), the NPL ratio declines but it is difficult to measure the extent of improvement in the overall financial sector to assess the net effect.

73. Research is on-going to include political factors in the early warning studies as well. As a result, researchers have come up with measures of political development and corruption, which is clearly important but hard to quantify and develop as a model. Recently, the quality of institutions, the central banking dependence and the quality of supervision have been taken up as indicators in measuring politics as a factor to identify early warnings. Another factor is the contagion impact in different forms from other countries. Examples include: (i) the US is facing a recession; but because it is a large partner in trade, Canada is also expected to suffer a similar recession as well; (ii) a competitive country encounters a big devaluation, as a result its counterpart will observe a fall in its competitiveness; and (iii) in the case of Asian crisis,

there were herding and wake-up effects, the clear case was that once Thailand was hit by the crisis in early 1997, many international investors considered that other Asian countries might face similar problems and this led to a common lender effect, which is interpreted to mean that you are affected if you borrow heavily from a country that also lends to a country that has a crisis. Banks in this case would reduce their exposure to emerging economies. There is a variety of indicators that can be useful to highlight the problems in the banking sector such as share of foreign banks as a popular indicator, meaning that more foreign banks would lead to a stronger banking sector.

74. The study indicates that all the studies confirm that knowledge about the past performance of an economy is no guarantee for future performance because future crisis can have different characteristics. Meanwhile, early warning systems are being used by a variety of market participants in the financial sector including bank supervisors, fund managers, international financial organizations and the like, in order to assess how much risks they are taking with loans to different countries. It is possible that they may find different assessment based on their own judgment even for the same banking sector and may make different lending and investment decisions from others. Furthermore, they have different perspectives on making investment decisions such as the portfolio investors have short-term perspective to draw liquidity from the emerging markets, while direct investors, on the other hand, have a long-term perspective. The nature of the early warning system, therefore, can be interpreted differently depending on the interest of market participants who use it.

75. In the third part of the presentation, Hawkins discussed the practical application of early warning indicators at the BIS. The BIS selected 24 most important emerging economies compared with the world economy that can have the contagion impact and also looked at the signs of pressure in the financial market. The BIS also examined the market fundamentals as well as the assessment of the national economies by rating agencies. Conceptually vulnerable countries can trigger crisis but it is almost impossible to convincingly explain why crisis breaks out in some countries at a particular point in time. The BIS method is therefore based on the two-wing system of vulnerability that is the external and banking sector vulnerability. A consensus has been made on variables that are conceptually important and on setting a certain score range such as 1-10, in which a score of 10 means maximum concern and a score of 1 minimum concern. There are two principles of the BIS method, namely, to keep it simple; and to look for the viable and timely indicators, rather than a complicated black box.

76. Hawkins explained the different sets of variables selected by the BIS as warning indicators to forecast a specific financial vulnerability, such as: (i) exchange rate, international reserves and interest rates to forecast the financial crisis; (ii) the real effective exchange rate, deviation from the size of current account, growth in exports, size in external debt and short-term debt to measure the external vulnerability; and (iii) the rapid credit borrowing internationally or lending domestically to measure the banking sector vulnerability, which means that a bank will have problems with high interest rates and low bank credit ratings. Using the BIS early warning indicators, the results show that before the Asian crisis, Thailand and Korea were vulnerable, as both suffered from large external borrowings and high short-term debts. Thailand also had the problem of a weak banking sector. While Indonesia did not look particularly vulnerable prior to crisis, which suggests that the reason for the Indonesian crisis was the contagion impact compounded by political uncertainties inside the country, though it is difficult to quantify it. In conclusion, he said that according to econometric analysis ,the vulnerable countries are more likely to have a crisis than others.

77. In the **open discussion**, Adams asked for further explanation on the selection of indices and imposition of weights. In response, Hawkins admitted that sometimes being judgmental is deemed as arbitrary. He explained that to distinguish significant indices to take as the signals of a crisis, literature on the early warning systems was reviewed and a consensus-building process was followed. Then both econometricians and practitioners would carefully analyze them again. Hence, there is a little possibility for the selection of variables to become arbitrary. Finally, the examination and adoption of indices were made through a consensus and an accurate testing process.

78. A participant asked if there was any research available on the better performing variables in forecasting the occurrence of a crisis in the specific economic situation such as Hong Kong, China with fixed exchange rate regime. Hawkins said that a surveillance system of foreign exchange crisis, for instance, needed to monitor the trends in foreign exchange reserves and interest rate as measures for financial pressure to build up in the case of fixed exchange rate system.

79. One of the participants asked whether the probit and logit regression analysis or imposing weights on the vulnerability indices would improve the surveillance model's ability to predict a crisis. Hawkins replied that it is difficult to decide which model is more effective because the studies using econometric models could have different results depending on the definition of indices, sample design and period, and the nature of a crisis. That is why researchers sometimes need to allow their own judgment to intervene in designing an early warning system over econometric analysis. To strengthen the prediction ability of a model, it is important to control the measurement problems. Qualitative indices including political stability, financial supervision efficiency and business management were also adopted to build up more effective surveillance models.

80. Hawkins cautioned that during the application of an early warning system, there is a possibility that weights might change over time such as the case of the Asian crisis. In the case of Latin American's crisis, the extent of the current account deficit and the inflation rates were reported as high-weight variables. While in the Asian crisis, crony capitalism and short-term debt were the high-weight indicators.

Managing the Globalization of Finance —Individual Country Level Initiatives

81. During the process of restructuring, liquidity payment mechanism should be maintained for the revival of the financial markets in the initial months of the crisis. Moreover, one also wants to maintain and restructure the over-indebted but financially feasible borrowers. During the implementation of the policies to resolve such financial distress, one can encounter the coordination problem that is which sector should be restructured first, corporate or banking. Another problem is the conflict between public and private sector on the priorities, because government is usually interested in macroeconomic management but private sector wants to take step in restoring corporate confidence through renewal of capital flows. In addition, government may face some problems in the process of building up credibility and consistency to have the market realize that the public sector's package is better.

82. **Claessens** discussed three phases of the systematic financial restructuring: (i) the containment phase; (ii) the restructuring phase; and (iii) the deeper reform phase. The short-term containment phase is crucial; this lasts only a few months but most of the mistakes are made during this period. The fiscal costs can either be recovered or ballooned. On the onset of the crisis, already the bad financing problem has already existed in the system but not realized by the authorities before symptoms began to erupt. In the restructuring phase, the government took such measures as using the full-blanket deposit guarantee to restore investor and depositor confidence, which was distorted during the crisis. In this phase, the government is advised to move quickly but carefully, in fact, the policymakers have to take certain and consistent actions to gain investors' confidence. The fiscal costs of the large-scale liquidity support should be carefully calculated and as a result of this policy, bad financing should be uprooted.

83. In the case of corporate sector restructuring, two different approaches can be considered. Under the centralized approach, the government takes over banks bad assets through its AMC. In the decentralized approach, there is a risk sharing between the public and the private sector, the government provides partial coverage of funds as an initiative to banks to take over NPLs. In either case, preconditions for corporate restructuring should be in place such as workable bankruptcy system and voluntary workout programs, absence of ownership links between banks and corporations, and loss and absorption system with the government playing a key role in providing an enabling environment. In conclusion, Claessens provided some empirical evidences from the survey-based studies to show how a good policy choice can lead to effective financial restructuring and can bring out quick recovery.

84. In the **open discussion**, one participant asked for some further explanation on the extent of government involvement in implementing the crisis-related policies and also what should be the right policies because she said that in reality, it is hard to accept that the government would give a limited policy response to financial distress and to keep away the faltering banking sector from problems. Clasessens replied that according to empirical findings, the liquidity-support AMCs and insurance guarantee would not always be successful in the process of restructuring, as a result fiscal cost would get bigger.

85. He argued that the government should intervene very carefully in the process of closing the insolvent banks and should try to choose a more limited approach. In the limited approach, the government guarantees only limited deposits and does not force the AMC to purchase all the bad assets. The limited approach will eventually help the government to keep away from the high fiscal costs and excessive intervention in crowding-out the recovery process.

86. Concerning the effects of government's injection of fiscal resources, one of the participants argued that before moving on to privatize the state-owned banks, re-capitalization and injection of financial resources are necessary to help raise the selling price. In the meantime, the government does not need to spend a significant amount of money in resolving the NPL problem and in conducting the banking sector restructuring such as the case of Poland and Argentina. It is cautioned that it is impossible to draw the common policy implications from different countries in different circumstances, but lessons can be learned from country specific experiences.

87. **Dr. Jang Bong Choi of the Korea Institute of Finance,** gave a presentation on **"The Korean Experience of Building a Sound and Efficient Financial System by Establishing an Efficient Financial Safety Net".** Choi began the presentation by characterizing the nature of the financial crisis in Korea in 1997 as stemming from structural weaknesses due to market protection, intervention, moral hazard and rapid economic growth driven by the government. The financial sector had been suffering from the government's continuous intervention since the early 1960s. This led to impeding market competition, and lack of discipline and accountability in financial management. A sharp increase in the short-term borrowing after financial liberalization and corporate bankruptcy in 1997 caused the rapid rise in NPLs in financial institutions. With the appropriate prudential regulatory system in place, the full-blanket deposit insurance scheme was introduced.

88. To resolve the financial crisis, Korea needed to carry out structural reforms, specifically in the financial and corporate sectors. A prerequisite of structural reforms requires the creation of a sound and efficient financial system. One important lesson learned during the crisis is that sound and efficient financial system is necessary to resolve such a crisis. The Korean experience confirms that efficient financial safety net is an important part of the system for restoring financial stability.

89. Choi identified two categories of measures to maintain safety and soundness in the financial sector. These are ex-ante and ex-post preventive measures. The former is the prudential regulatory system and the latter is the system of lender of last resort, payment, settlement, and deposit protection. Among them, the deposit protection scheme is intended to abort contagion effect, protect small depositors, and eventually help in stabilizing the system. The measures taken in Korea were aimed at stabilizing and restructuring its financial sector and at establishing an efficient and sound financial system. Two major measures taken were: (i) enhancement of the central bank's independence; and (ii) installation of a consolidated supervisory body. The prompt corrective action (PCA) was aimed at: (i) making the intervention less discretionary; and (ii) reducing the failure costs. Some other measures were also introduced to improve the financial institutions' capacity to control credit risks more effectively.

90. The FSS and FSC were merged and two more organizations, namely, the Korea Asset Management Corporation (KAMCO) and the Korea Deposit Insurance Corporation (KDIC) were established to restructure the financial sector and to establish the financial safety net. Before the establishment of KDIC in 1996, there was no deposit insurance system. The KDIC was a replicated model from Canada and the US. In order to maintain stability in the market, the scope of deposit insurance was broadened. At the end of year 2000, the full-blanket system was replaced by the partial insurance scheme. Choi noted that Korea has found improvement in some of the indicators after the crisis period and since March 2001, Korea has been undergoing a second round of reforms.

91. In the **open discussion**, one participant asked the presenters to explain in greater detail on the background of the recent shift from the full-blanket to the limited deposit insurance system in Korea and also the market's reaction to such changes in the guarantee system. She assumed that this shift might generate the safety in response to such a restructuring policy but there was a possibility it might also cause an anxiety in the market. Other participants raised issues about the choice between the consolidated and scattered financial supervisory system.

92. **ADBI's Dr. Jae-Ha Park** explained that after the Korean economy began to recover from the crisis by resolving the foreign exchange problems, the rationale for the full-blanket system was reconsidered but the conclusion was that the system, even adjusted with the new developments in the economy, might aggravate moral hazard among the bad banks. Therefore, the original full-blanket system, which was designed to stabilize the economy quickly, has been replaced by a more universal partial guarantee system.

93. When the abandonment of the full-blanket scheme was announced, however, no serious market jitter was experienced. As the first round of the financial restructuring failed, Korea forced the bad banks to leave the market. Such decisions soon lifted the lingering risks in the banking and financial sectors and concurrently reduced anxiety among investors even without the full-blanket scheme. The shift to the partial guarantee scheme was made amid the heated debates over the question of reasonable ceiling and the extent of deposit insurance. Some experts acknowledged that despite the formation of the 50 billion won insurance fund, including the injection of an additional 30 billion won to the original plan, uncertainty remained in the financial system and it was feared that retention of the full-blanket system might merely spread moral hazard in the market.

94. Choi, who had served as the head of the Korean Financial Supervisory Service (KFSS), took the podium and spoke on the advantages of the consolidated financial supervisory system. He said that the general evaluation of such a system is that the consolidated operation of the financial supervision reduces the loopholes of the older supervisory service. A united supervisory system had also the capacity to introduce a more forward-looking and timely response using separate risk signals. As a result, the system became too strong after the integration of the related agencies.

95. Park added that it was the international trend to create a consolidated financial supervisory system since the 1960s and the shift towards a consolidated supervisory system was accelerated because of its recognition for achieving economies of scale .There was, however, no evidence that the integrated system was superior to the pre-existing system all over the world equally. Both systems have the same objective to build up a more effective and efficient information-sharing system, which binds the central bank, supervisory agency and the government. Under the same objective different approaches can be undertaken depending on the country-specific environment.

96. **Dr. Stijn Claessens**, gave his second presentation on **"Electronic Finance: Reshaping the Financial Landscape around the World".** He expressed the view that the recent wave of e-finance would change the financial landscape around the world. He highlighted the latest developments in e-finance by highlighting the features of the new financial landscape, potential growth, and suggested implications for public policy and its implementation.

97. Claessens explained the importance and benefits of the new financial landscape to the emerging markets. He said that the new financial landscape is defined as globalization, deregulation, and advancement in information technology (IT) and mobile telecommunications. The level of globalization can be measured by the increasing trend in the volume of capital flow abroad as indicated by the size of its stock traded outside one's own country. For example, Israel is regarded as an extreme case of financial globalization, where it finds 90 per cent of its stock listed in the domestic market is traded in Nasdaq and elsewhere. Likewise, Argentina is another leader in financial globalization, where it sees 60 per cent of its daily trading volume transacted in foreign stock exchanges. Likewise, Venezuela has 47 per cent of its stock traded outside its own country. Deregulation is taking place in commercial and investment banking and products are increasingly becoming more similar.

98. Technological innovation is bringing several changes in the industrial structure, competitive landscape, process reducing costs and service delivery and, in general, is leading to benefit the consumers. The use of information technology in the financial sector to provide efficient services is becoming common such as electronic banking. The availability of financial services on the electronic platform provides information of various financial institutions at one place to make a comparison of the prices. The electronic banking is increasingly becoming linked with the telecommunications services, therefore one can also easily find the telecommunication services and other non-bank entities on the electronic media because such services are occupying more in market capitalization. Not only they are investing in the information technology but also entering into new businesses such as electronic payment services at lower cost. Technology is also giving rise to the mergers of various firms because the entry of too many new businesses are lifting the value of a brand name with increasing number of consumers who are seeking for more security and recognition. In the process, the merger of non-financial and financial companies is not only to seek the increased use of telecommunications technology but also it is an attempt to take over warehouse chains to distribute financial services.

99. In a graphic way, one can capture the rough structure of the future financial industry. During the period of brick-and-mortar approach, consumers could access banking services only by visiting the branches. Today one has a variety of entry points including Internet, mobile phone, and other access devices to the private and public sector banking network. Moreover, there is a new type of financial services called "aggregators" such as *Insurance.com*, which help the clients to find lower cost insurance by providing various price quotes, and ensuring more transparency and clarity in the process. The production distribution is also changing its structure with the entry of new types of financial institutions, which provide specialized services on the electronic platform and can be accessed directly through electronic device. Products are new, too, such as electronic bill presentment and e-wallets.

100. Claessens explained that nevertheless, there are barriers in different forms such as: (i) "commoditization", whether technology can be readily transformed into products with better quality at lower cost; (ii) regulatory barriers are also high therefore non-bank institutions such as telecommunications cannot enter in the banking service even if they are qualified in networking and access; and (iii) other barriers such as investors' tailor-made advice, are inherent in terms of capital and reputation in products, which can hardly be commoditized, therefore, the magnitude of change is varied across financial products, however, it is widely accepted that the scope of changes can be broader. Internet is a new distribution channel and very effective in stratifying customers according to their interest and preference of products. In this era of Internet, the potential market size is much larger. Other benefits are the reduction in asymmetric information among customers and banks, and wider access to small and medium-sized institutions.

101. The emerging markets are increasingly adopting the e-finance. The average share of e-finance in the world is 5-6 per cent, but it goes as high as 35 per cent in Turkey and 30 per cent in Korea, meaning that e-finance is spreading very fast. The benefit of fast penetration of e-finance is favorable for business environment especially in the emerging markets. It is hoped that the share of e-finance will increase in the future.

102. E-finance is influencing the financial sector related policies. During the process of the development of telecommunication infrastructure, the reinforcement of security in the open network and technological innovation should be pulled together, while former being framework of the infrastructure and latter as the physical environment. In the process, regulations to enhance the privacy protection and to prevent the anti-competitive behaviors should be introduced but, in the meantime, government also needs to install credit rating agencies, which can be freely accessed in a bid to balance privacy and the quality of service. At the international level, regulators need to cooperate with each other to tackle various problems related with the cross-border enforcement of regulations. Claessens argued that the emerging economies are expected to move from traditional system to e-finance to cope with other developed countries. For this purpose, the preconditions are the installation of functional institutional frameworks and technological infrastructure as well as resolving under-capitalization problems in the financial sector. Above all, the government needs to accelerate penetration of e-finance by encouraging people to be more connected and by promoting a favorable environment for e-activities.

103. In the **open discussion**, most of the questions asked about the implications of e-finance and its future prospects. In response to a question about forecasting the future of e-finance, Claessens said that some of the indicators in the analysis could be misleading due to ambiguity of the definition of variables, and technical difficulties in collecting and interpreting data. In general, however, the speed of the take-off in e-finance is obviously dependent on the business environment of a country. Good connectivity is another indicator that analysts used to predict speed and depth of penetration of e-finance and mobile banking. Hawkins named it as one irony that e-finance facilitates transmission of information but tracing the trends of e-finance is still an arduous process.

104. One participant asked about the possibility of financial liberalization during the new round of multilateral trade negotiations and role of the government in proliferation of e-finance. Claessens predicted that the New Round could obviously take this issue seriously and countries that are taking regulatory measures for across-border services at the moment will face a high competition. Even though, country/institution responsible to regulate the financial globalization is yet undecided but efforts for better harmonization of standards, enhanced cooperation and more information sharing should go on.

105. Most policymakers are not taking repercussions of e-finance on money supply as a serious threat for their monetary policies. The European Union (EU), for instance, has recognized the effects of e-finance on its monetary policies, but policymakers in general are not much concerned about the disturbances which e-finance may create. Park and Hawkins noted that the BIS had collected the studies on the subject of impact assessment of e-finance on the money supply and monetary policy, and participants were encouraged to share them.

Group Discussion and Presentation —Country Experiences

106. During the last session of the seminar, participants were divided into 3 groups of 9 members each. Each group discussed and exchanged views on the challenges, which Asian developing countries were facing in the process of financial sector reforms. Each group subsequently presented the outcome of their discussions.

107. **Group A** consisted of members from **Bangladesh; Cambodia; Hong Kong, China; India; Indonesia; Korea; Malaysia; Singapore; and Taipei,China** opened the session by highlighting the recent developments in the macroeconomic situations and financial sector in the country-specific circumstances. The problems faced by some of these countries were identified as: (i) high inflation in Indonesia; (ii) shrinking exports in all 9 countries except Indonesia; (iii) insufficient foreign exchange reserves in Bangladesh; (iv) high external liability level; and (v) volatile exchange rate in Indonesia. In the financial sector, despite progress in information and communication technology, the Asian developing countries are not well equipped with equivalent regulatory framework to govern e-financial transactions as the presenters noticed. In almost all countries, amid the globalization and liberalization in the financial sector, the external shocks had been immediately transferred to the domestic economies, which mean that financial sector reforms would become more arduous.

108. In the banking sector, Group A identified that the NPL ratio exceeded the reference level of 5 per cent, particularly in Bangladesh, Korea, Indonesia, Taipei, Malaysia, India, and Cambodia. In the meantime, Bangladesh, Indonesia and Cambodia had their capital adequacy ratio lower than the BIS benchmark of 8 per cent. Indonesia and Korea were characterized as suffering from limited bank lending, one of the causes of a bottleneck situation in the money market. Stock market volatility, and mal-functioning of trading in the secondary market for bonds and government securities were observed in capital markets across Asia, while the lower sovereign ratings were identified as aggravating problems by deterring India and Indonesia from gaining access for raising fund in the international market.

109. Group A recommended some policy implications to strengthen the banking sector and the financial market. For the banking sector reform, the presenter referred to Yoshitomi's recommendations on stressing the importance of the regulatory framework and the establishment of the AMCs. To build up a healthier banking sector, re-capitalization of weak banks and privatization of state-owned banks were regarded as priorities especially in countries like Bangladesh. Corporate governance should be reformed and enhanced by introducing strong disclosure system, while the insurance deposit fund was recommended as a useful instrument to manage risks as well as a preventive measure against moral hazards. Furthermore, there was a need for an enhanced early warning system so that they could differentiate between weak and strong banks and facilitate incentives to reduce the NPLs.

110. It was realized that the main problem in the Asian financial markets was the over-reliance on banks and the limited scope for other means of funding. Therefore, Group A argued that the capital market needed to be equipped with an effective regulatory framework. Government needed to impose strong disclosure standards, allow pension funds to be invested in the capital market, and rationalize government savings schemes, which were particularly reckoned as priority in Bangladesh. Other instruments such as domestic credit rating agencies, financial guarantee insurer system, development of the fund management industry and reduced issuance costs and taxes were proposed to be put in place.

111. On the whole, Group A ended up with the conclusion that policymakers needed to respect peculiarity and differences of each economy and take a comprehensive and integrated approach. With reference to Yoshitomi's lessons, participants agreed that appropriate sequencing and phased development should be achieved in developing and implementing policies. Above all, consultation and coordination together with commitment and concerted efforts across countries were required to address present economic challenges and to sustain the financial sector reform.

112. In the **open discussion**, one of the participants raised the question on what were the recent developments in the early warning system in participating countries and difficulties for accurate forecasting. A member of Group A replied that even though the early warning systems were not perfect, but there was no harm to try them. He stressed that analytical views and theoretical groundings would make up the deficiency in the currently imperfect forecasting system. Dr. Jeffrey Liang of ADB, cited the lecture by Hawkins on the early warning system, and added that Hawkins did not present tools of prediction but scenarios that would help to detect volatility in banking and capital markets.

113. Group B gave a presentation on **"Financial Sector Reform and Cross-Country Experiences",** covering the cross-country experiences in financial sector reforms and comparing immediate responses on the onset of the financial crisis in 1997. Ms. Asha Kannan from India, on behalf of her group, highlighted that there had been wide differences in the process of financial sector reforms among Asian countries and there was no one-size fits all solution for all Asian countries.

114. Factors that led to the financial crisis were examined in a country-specific approach. In the banking sector, the following problems across countries were observed: (i) direct and connected lending; (ii) weak monitoring and functions of the banking sector; and (iii) weak financial system. The dominance of banks in the financial market is also identified as a common source of problem in most of Asian countries. The external factors contributed to the eruption of the Asian crisis were identified as: (i) the voluminous short-term external liabilities; (ii) large current account deficits; (iii) foreign exchange reserve imbalances; and (iv) inappropriate exchange rate regimes. Exposure to contagion effects under the open capital account was another external factor triggering the Asian crisis, while countries with a closed capital account such as Bangladesh, India and Pakistan were less affected by the Asian crisis. Group B identified other factors including political instabilities in Indonesia, large corporate sector in South Korea, declining oil prices in Indonesia as well as the lack of early warning system, which were the causes of the Asian crisis.

115. The nature and magnitude of crisis across the Asian countries were different, which resulted in different countries adopting different measures to reform their systems. In terms of the nature of crisis, the East Asian countries were faced with severe problems in the financial sector, while Bangladesh, Pakistan, India and Taipei,China had suffered from some volatility in the foreign exchange market. One exceptional case is Hong Kong, China, which did not face much foreign exchange problem because of the currency board arrangement. The People's Republic of China could also avoid crisis because of its large foreign exchange reserves.

116. The measures such as the dissolution of NPLs, re-capitalization and reinforcement of financial institutions, and closure and merger of weak and non-viable banks or institutions, were taken to revive the banking sector. The countries with large share of government—owned banks, undertook the process of privatization. Efforts were made to implement prudential measures, asset classification and provision requirements, and capital adequacy norms. The asset-liability and risk management systems as well as internal supervision and monitoring systems were promoted. Some countries adopted the deposit insurance schemes and claimed better data reporting, monitoring and more transparency. The following steps were taken to restructure the financial market: (i) promotion of underdeveloped capital and bond markets; and (ii) many countries permitted foreign participation. The stabilization of exchange rates and mitigation of impact originating from globalization were targeted to resolve external sector imbalances. The process of restructuring the public and private sectors' debt and countries like India, Bangladesh and Pakistan exerting their efforts to improve the composition and size of foreign reserves as well as stabilize exchange rates help to bring about improvements in their economies.

117. In the **open discussion**, a participant asked which measures should be taken to handle the problems stemming from growth of e-finance. Group B discussed the regulatory, payment and settlement, and cross-country dimension of the problems. They recognized that despite deficiency of data, the rise of e-finance is so obvious. Concerning prospective problems in the international penetration of e-finance, they called for international dialogue and cooperation to make collective efforts to solve the possible problems.

118. **Group C** discussed **"The Management of Risks Related with Financial Instability and Respective Country Experiences".** Group C began with identifying common interest in crisis resolution, managing capital account liberalization and related problems due to over-reliance on the banking sector. Group C categorized countries into several groups depending on the depth and magnitude of problems each country faced in the capital market and banking sector. They then differentiated the solutions undertaken by the countries and concluded that the priority is for a policy depended on the nature of crisis.

119. Countries faced the challenge of capital account liberalization differently, for example: (i) some countries needed to attract foreign technology and capital to finance the gap between savings and investment; (ii) on the other hand, premature liberalization resulted in capital outflow because they were forced by multilateral organizations to be more open; and (iii) favorable capital liberalization stimulated volatility in asset price and exchange rates, in fact, some Asian countries had experienced high volatility in capital flow during the high dependency on the foreign capital markets by making domestic economy less efficient in saving mobilization. Group C gave the following policy recommendations for capital account issues: (i) temporary exemption of capital flow should be seriously considered; (ii) many countries had the strong need to attract long-term foreign direct investment (FDI), ensure exchange rate stability and proper resource allocation, and develop hedging tools and policy instruments to handle exchange rate volatility.

120. There was a great need to handle the problem of the over-reliance on banking sector finance. The Asian countries also had to handle the challenges related with the high portion of state-owned banks, limited autonomy in decision-making and constraints in market-oriented approaches, and underdeveloped bond market. Also, the determination of interest rate by the government often crowded out private sector borrowing. The lack of regulatory regime and the problem of moral hazard due to the implicit government guarantee were also indicated as additional challenges in the process of banking sector reforms. Group C discussed that banks should be consolidated through M&A, liberalized entry of foreign competition and new technology were essential policy considerations. They also suggested the importance of stronger prudential supervision and removal of implicit guarantee on banks as an alternative instruments to promote savings. To prevent banking crisis, early warning indicators should be developed while roles of such external parties as accountants, lawyers, and credit rating agencies should be activated. Deposit insurance system was necessary and corporate governance should be reformed.

121. Group C concluded with lessons learned from the Asian crisis in terms of crisis management: (i) sound macro and prudential policies and adequate safety net should be implemented; (ii) gradual liberalization should be pursued with appropriate rules and regulations as well as monitoring tools; (iii) regional cooperation and coordination should be promoted; and (iv) legal infrastructure and institutions should be introduced to facilitate management of distressed assets and crisis resolution.

Concluding Remarks

122. **Dr. Park** and **Mr. Liang** jointly closed the International Finance Seminar. They congratulated the participants for the successful completion of the seminar. Participants also thanked the organizers, the ADB Institute, the ADB and the KIEP who had made it possible to establish networks among the Asian financial policymakers as well as to exchange views with experts on the fast-changing international financial sector.

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