NO.

Directions for Cooperation in Institutional Development in Developing Countries (Economic Soft Infrastructure)

March 2003

Committee on Cooperation in
Institutional Development for Markets
Working Group on Economic Soft Infrastructure

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Introduction

In order to contribute to the industrial and economic development of developing countries, Japan has been providing technical assistance such as the transfer of industrial technologies to developing countries and the recommendation and proposal of policies for industrial/economic development. The Asian currency crisis has brought about an increased awareness in Asian countries with regard to the importance of development of institutions and policies that will provide the foundation for sustainable industrial development. Also the rapid progress in economic integration and trade liberalization in East Asia has brought recognition needs for institutional building such as in the field of harmonization and the creation of international standards. Developing countries must respond appropriately to this situation, and examine and implement strategies to secure the benefits of globalization. Also Japan must study approaches to assistance in the area of institutional development in order to bring about economic and industrial development in developing countries.

Based on a recognition of this situation, and with the objective of considering future assistance policies and effective assistance methods in order to help developing institutions and strengthening markets in developing countries, a "Committee on Cooperation in Institutional Building for Markets" was set up in October 2001 by the Regional Department I (Southeast Asia and Indo-China) and Mining and Industrial Development Study Department of the Japan International Cooperation Agency (JICA). With the participation of experts and relevant government agencies and institutions, this committee studied the future direction of assistance for institutional development, primarily in the East Asian region, and discussed the approach to Japan's assistance in this field. Discussions by the committee were conducted in two working groups: the "Working Group on Economic Soft Infrastructure," which dealt with institutions to ensure the smooth circulation of funds and capital, and the "Working Group on Strengthening Industrial Competitiveness," which dealt with institutions relating to facilitate corporate activities in the marketplace in terms of trade, investment and competition.

The chair of the Working Group on Economic Soft Infrastructure was Professor Shinji Asanuma of Hitotsubashi University. In a total of nine meetings, discussions were held regarding the future direction of assistance to developing countries in terms of improving systems relating to Banking Sector, Capital Markets, Accounting, Corporate Governance, and Financial Legislative Infrastructure. This report sums up these working group discussions in the areas of international trends, domestic situation, foreign assistance, and points and directions for assistance. It is hoped that this report will contribute to future examination of assistance for developing countries in this area.

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As of October 2002

1 Up to the 6th meeting Kazuo Hiramatsu (Professor, Kwansei Gakuin University)
2 After the 7th meeting Nobuo Yamazaki (Section Chief, Regional Financial Co-operation Division)
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9 Up to the 8th meeting Takeshi Hatakeyama (Director, Indo-China Division)
10 Up to the 6th meeting Kae Yanagisawa (Director, East, Central Asia and the Caucasus Division)
11 Up to the 8th meeting Hidetoshi Takama (Director, First Technical Cooperation Division)
12 Up to the 8th meeting Toshihiro Obata (Director, Second Research and Development Division)

Discussions by the Working Group on Economic Soft Infrastructure

First meeting	**Establishing directions for the overall discussion** October 16, 2001 • Procedures for the working group: Secretariat • Asian currencies and financial cooperation: Mr. Asakawa, Director, Regional Co-operation Division, International Bureau, Ministry of Finance • Issues facing Asia's banking sector: Professor Okuda, Hitotsubashi University
Second meeting	**Delineating the overall discussion and issues** November 27, 2001 • Summary of previous discussion and supplementary explanation: Secretariat • Rapidly decelerating Asian economies and Issues facing the financial sector: Mr. Sakuma, Manager, Research Office, Bank of Tokyo-Mitsubishi • Directions for financial market structures based on the Asian economic crisis: Associate Professor Shirai, Keio University
Third meeting	**Corporate Governance** December 27, 2001 • Corporate governance in Asia: Secretariat • Reform in corporate governance of family businesses and the need for a comprehensive approach: Associate Professor Fukagawa, Aoyama Gakuin University • Establishing a desirable legislative system for business in Asia: Associate Professor Kaneko, Hiroshima University
Fourth meeting	**Direct Financing** January 25, 2002 • Overview of Asia's securities markets: Secretariat • Characteristics of Asia's securities markets and cases of cooperation by the Tokyo Stock Exchange: Mr. Sakakibara, Head, Overseas Public Relation, Tokyo Stock Exchange • Issues and ways to develop capital markets in Asia: Professor Aizawa, Saitama University
Fifth meeting	**Accounting and Auditing Systems** February 20, 2002 • Overview of Asia's accounting and auditing systems: Secretariat • Improving the accounting infrastructure in developing countries: Mr. Yamazaki, Exective Director, The Japanese Institute of Certified Public Accountants • Activities of the Financial Accounting Standards Foundation: Mr. Matsuyama, Director/Secretary General, Financial Accounting Standards Foundation • Japan's contributions to accounting standards in Asia: Professor Hiramatsu, Kwansai Gakuin University
Sixth meeting	**Indirect Financing** April 5, 2002 • Report of Field Study in Thailand: Secretariat • Overview of Asia's banking sector: Secretariat • State of overseas technological assistance (TA) by Bank of Japan: Mr. Nakajima, Manager, International Department, Bank of Japan • Demands facing Asia's banking sector and ways to overcome these challenges: Mr. Sakuma, Manager, Research Office, Bank of Tokyo-Mitsubishi • Issues facing the banking sectors of Asian nations, taking Indonesia's financial sector as an example: Professor Komatsu, Hiroshima University
Joint working group meeting	**Joint working group meeting** May 17, 2002 • Working group review: Secretariat • Need for institutional development and future steps: Professor Kimura, Keio University, and Professor Asanuma, Hitotsubashi University

	• Summary
Seventh meeting	**Financial Sector in China** May 20, 2002 • Overview of China's financial sector: Ms. Hagiwara, Bank of Tokyo-Mitsubishi • China's financial sector: Ms. Watanabe, Institute of Developing Economies - JETRO • Report of Field Study in Indonesia: Secretariat • Discussion of report preparation: Professor Asanuma, Hitotsubashi University
Eighth meeting	**Preparation of working group report** July 15, 2002 • Discussion on the working group's draft report
Ninth meeting	**Preparation of working group's report** October 7, 2002 • Discussion on the working group's 2nd draft report

Table of Contents

Appendices

Field Study Analysis of Current Situation

List of Abbreviations

ADB	Asian Development Bank
ADR	Alternative Dispute Resolution
ALM	Assets and Liabilities Management
AMC	Asset Management Corporation/Company
ASBJ	Accounting Standards Board of Japan
ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
BNM	Bank Negara Malaysia
CAR	Capital Asset Ratio
CAS	Country Assistance Strategy
COS	Country Operational Strategy
DAAA	Division of Administration of Accounting Affairs
FASB	Financial Accounting Standards Board
FTA	Free Trade Agreement
FMRPL	Financial Market Reform Program Loan
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
IASC	International Accounting Standards Committee
IAS	International Accounting Standards
IFAC	International Federation of Accountants
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IR	Investors Relations
MASB	Malaysian Accounting Standards Board
NPL	Non Performing Loan
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PHRD	Policy and Human Resources Development
ROSCs	Reports on the Observance of Standards and Codes
RTGS	Real-Time Gross Settlement
SEC	the Securities and Exchange Commission
SMEs	Small and Medium Enterprises
TAMC	Thai Asset Management Company

TA	Technical Assistance
UNIDO	United Nations Industrial Development Organization
WTO	World Trade Organization

Chapter 1: Fundamental Considerations

1.1 Objective of the Working Group

In recent years, for the sake of sustainable and autonomous economic development, which is indispensable for the eradication of poverty in developing countries, a consensus has formed among policy makers and academics concerning the importance of institutional development. This understanding has become prevalent for three reasons. The first is the lessons derived from the experiences of developing countries over the past fifty years, along with the lessons learned from the history of official development assistance (ODA). The second is that, as adaptation of market economy came to be a strategy for economic development, it was recognized that in order for market mechanisms to develop and function effectively, it is necessary to develop the institutions that support those mechanisms. The third reason is the trend toward globalization in the latter half of the 1990s, and the experience of the Asian crisis.

Institutional Development is a broad concept as it includes matters of different hierarchical levels and various methods of arrangement. Several different regions could be considered, but for the purposes of this report we will discuss about Asian countries, and in particular, the countries of East Asia[1] that have been greatly affected by the Asian crisis.

The issues revealed by the Asian crisis are an important subject. The Asian crisis suggests that, for future economic development, the East Asian countries need to catch up in two important policy areas. First, they need to correct the current situation in which the development of the financial sector, a core mechanism for economic growth, lags behind other sectors. And second, to improve both their ability to avoid economic crises and their industrial competitiveness, they need to achieve steady technological progress as semi-developed countries. In an international economic environment of increasing globalization, it is essential for the countries of East Asia to catch up in these two areas in order to achieve continued sustainable and autonomous economic development.

The working group on Economic Soft Infrastructure has studied systems and institutions, particularly in the financial sector, which are related to the smooth distribution of funds and capital to be used for catching up in the first of these two areas.

1.2 Institutional Building and the Financial Crisis

(1) Financial Situation of East Asia

The member countries of the Association of Southeast Asian Nations (ASEAN) began to experience rapid growth in the mid-1980s, as well as infusions of technology and capital through direct investment by foreign corporations. To implement this policy of industrialization through foreign investment, the ASEAN countries liberalized their financial sectors and moderated their laws on foreign investment in order to support the activities of foreign corporations. At a relatively early stage of industrialization, the ASEAN countries adopted liberal financial policies, including the relaxation of regulations in the areas of interest, services, and foreign exchange. This is in contrast to the situation in South Korea and Taiwan, which began to liberalize their financial sectors only after their heavy industry basically had been fully developed.

However, this economic development through foreign corporations did not advance or modernize management practices in local corporations and banks through stronger ties

[1] In this repot, “the East Asia” refers to Thailand, the Philippines, Indonesia and China.

with foreign corporations and banks. There was no chain reaction[2] of adequate effectiveness in the financial sector. As modernization lagged behind in these markets, a trend gradually appeared toward wasteful financing of foreign capital, and the mediation(including period conversion) of domestic savings that had accumulated during the period of economic growth pursued increasingly high-risk, high-return oriented, while risk management remained immature with regard to exchange risk and the like.

When the financial crisis occurred in this situation, the weakness of both the financial sector and the corporate sector was exposed. This weakness was due to delay of setting timely steps to be taken to develop the soft financial infrastructure, while industrial policy focusing on investment, was emphasized. The result was a lack of adequate functioning by the mechanisms that link savings to investment and form the core of economic growth. In each of these countries, local banks experienced a capital shortfall as foreign banks rapidly withdrew funds, and exchange rates fell sharply. Financial institutions were left holding large amounts of non-performing loans, and corporations were saddled with excessive obligations, accelerating the real economic decline. The falling exchange rates did no result in strengthening industrial competitiveness. On the contrary, since the nations' economies were centered around export industries that depended on imports for parts and so on, production activities became depressed on the whole, and investment also fell off sharply.

After the crisis, the governments addressed the issue of non-performing loan (NPLs, hereafter) disposal for financial institutions, while also strengthening the monitoring and supervision of financial institutions, including prudential regulations. Foreign banks began to actively enter retail markets taking the opportunity that foreign banks were invited for the disposal of failed financial institutions. However, still struggling under a massive weight of NPLs, some local banks have actually reduced the finance to small and medium enterprises due to inexperienced monitoring functions and inadequate knowledge of financing, in addition to their fundamental weakness. Instead they are placing more emphasis on small loans and consumer loans. The development of capital markets also remains problematic. Thus, we see that the financial sector, which should support economic growth, has failed to fulfill its basic role for because of the remaining inadequacy of its soft infrastructure, along with excessive government intervention and a mismatch between the actual circumstances and the regulations and supervision. There is a growing awareness that in order to achieve sustainable economic growth, it will be necessary to improve and reform the entire financial sector, and to correct the current situation in which development of the financial sector lags behind that of the industrial sector.

(2) Need for Institutional Building in Economic Assistance

There is also a strong awareness among donors concerning the importance of institutional building, due in part to the spread of the market economy approach and the move toward standardization and harmonization of global systems. It is also recognized that sustainable development of developing countries will require the firm establishment of sound economic policies, strong institutions, and good governance. This is becoming the international consensus, and in regard to assistance as well, there is a growing awareness of the importance of building an environment where these three conditions will be more easily satisfied. Since the hard infrastructure, which has conventionally been the subject of

[2] This refers to the process in which growing competitiveness in financial markets, the entry of foreign banks, and the introduction of foreign capital lead to a shift in the main focus of financing by local banks from their previous major target of large, outstanding corporations to small and medium enterprises, expecting that this would make financial services available to a wider range of customers.

assistance, is already in place to a certain extent, it is generally believed that the focus of assistance should shift from hard to soft infrastructure development.

In East Asia, regulations and standards in areas related to the financial sector have been increasingly standardized since the crisis, initially under the government's leadership. For example, in the midst of globalization, East Asia will need to conform to the Basel Core Principles for banking supervision, to international accounting standards for corporate accounting, and to wide-ranging principles with regard to the regulation of securities. It is expected that adherence by each country to internationally accepted standards and codes of good practice will lead to improvements in lending practices, investment, and policy administration, which will result in better economic performance. Therefore, the introduction of international standards and codes is being promoted, as seen in the Reports on the Observance of Standards and Codes (ROSCs). Assistance will be a key factor toward smooth implementation.

(3) Response to International and Regional Frameworks

In the past, institutional development has been perceived in terms of a dichotomy between domestic institutional development on the one hand and multilateral efforts for institutional development on the other, the latter including efforts by the International Monetary Fund (IMF), General Agreement on Tariffs and Trade (GATT), and World Trade Organization (WTO). However, in recent years the need has arisen to accommodate the trend toward bilateral and inter-regional cooperation, which includes improving financial systems. This type of trend is also seen in Europe and elsewhere. Taking the example of Asia, the region that includes Japan, there is a move toward East Asian cooperation based on an ASEAN-plus-three grouping as seen in the Chiang Mai Initiative, the Japan-Singapore Economic Agreement for a New Age Partnership, and Prime Minister Koizumi's call during the ASEAN summit (January 2002) for a comprehensive economic agreement between Japan and the ASEAN countries. This is the result of a growing recognition that harmonizing systems that promote regional economic integration benefits those countries. This idea is based on the progress of global economic integration since the mid-1990s, as well as the experience of the Asian crisis.

It is important for Japan to contribute to the linkage of economic institutions in the East Asian region. In the midst of globalization, the economic revitalization strategy prepared by the Council on Economic and Fiscal Policy in June 2002 proposes building an environment to facilitate the creation of a free trade zone in East Asia by promoting a new round of WTO negotiations, as well as by fostering and strengthening economic cooperation through free trade agreements (FTA), abolishing various trade barriers, and promoting common and unified institutions.

This kind of movement and consistency is important when reviewing the past record of assistance related to the institutional development in the countries of this region. It is also important for indicating future directions for Japanese support in this area. In this study, it is vital to recognize the needs for reform and further developments throughout the financial sector, as the development of East Asia's financial sector has lagged behind that of its industrial sector. Also, in view of the current situation in Asia, it is necessary to move carefully when taking the approach of uncritical acceptance of institutional developments based on global standards.

1.3 Supporting Development of the Economic Soft Infrastructure

(1) Financial Infrastructure Development as the Subject of Assistance

In general, the concept of economic soft infrastructure includes such notions as overall economic governance and social capital, so the idea of improving the economic soft infrastructure covers a lot of ground. However, in approaching this subject as an important policy issue for the economic development of East Asia, it is appropriate to consider institutional development in light of the Asian crisis and development, focusing on the financial sector, which provides the core mechanism for economic growth.

The Asian crisis clearly revealed the weaknesses of East Asian financial and corporate systems. It exposed the serious lack of development of the financial infrastructure, including systems to regulate entry into and withdrawal from the market, reliability and clarity in financial statements and accounting standards, corporate database and credit investigation functions, audit systems and responsibilities, appropriate and effective government supervision, legal and judicial systems to guarantee smooth financing, and financial techniques for avoiding risk. Active efforts are also needed to develop the financial infrastructure from the standpoint of achieving a balance with future real economic development.

This report focuses on five areas involved in support that are issues of the basic infrastructure of the financial sector: reform of the banking sector, development of capital markets, corporate accounting, corporate governance, and the financial legislative infrastructure.

(2) Directions for Assistance

The financial structure of East Asia has not entered into full-scale development, although capital markets are gradually emerging. Banks are still at the center of the financial structure, and banks are the overwhelming choice of companies raising funds. When informal financing is excluded, bank loans are the greatest source of financing for small and medium enterprises and unlisted companies, which account for the majority of companies. Therefore, the top priority should be reforming the banking sector so that it can provide financial support to a wide range of companies in East Asia, primarily in the manufacturing industry, and thereby achieve sustainable economic development.

Meanwhile, concerning reform of the securities markets and stock markets, the basic mode of development of these markets is closely related to the phenomenon that occurs when national income reaches a certain level, causing changes in the way that assets are held, mainly by households. When this happens, a part of household savings becomes available for risk-taking, and the amount of this available risk money begins to increase.Since these markets move in step with the development of institutional investors, the securities markets of these East Asian countries should be reformed gradually and steadily.

Looking at the banking sector, since banks bear credit risk on the behalf of creditors, including depositors, repeatedly financing and obtaining internal information on borrowers in the course of establishing business relationships and eliminating the problem of asymmetry in information, it is possible to improve the function of loan intermediation through efforts toeliminate the problem of uncertain factors in information. In other words, since it is possible to keep the focus on banks when reforming the banking sector and to simplify the related parties to some extent, this sector is, in addition to being a priority issue, relatively easier to support than are the securities markets, which deal with a wide range of market participants.

Chapter 2: Banking Sector

2.1 Environment of the Banking Sector

(1) Trends in International Financial Markets

Although the 1997 Asian financial crisis has been resolved to some extent, there is still a continuing threat to the international financial system. As of 2001, there is an endless list of problems. Chronologically, these include an environment of continuing deflation caused by the collapse of the bubble economy in the world market for technology, media, and telecommunications, a series of recessions in the U.S. amid worldwide economic depression and the September 11 terrorist attacks, the financial crisis in Turkey, successive business failures, the collapse of the Argentine economy, and mistrust of corporate accounting after a series of scandals involving U.S. corporations. However, the international financial system has not collapsed under this environment. It has managed to survive. Major factors contributing to this endurance are the overall infrastructure of the financial system and the soundness of important players such as the supervisory authorities and market participants. However, the supervisory authorities are showing concern for the adverse influence of a wave of worsening corporate profitability in advanced countries due to the quality of the banks' loan assets. The contraction of risk-taking and the shrinking flow of capital into emerging markets are also becoming causes of concern as obstacles to the sustainable development of global financial systems.

(2) Characteristics of Banking Sector

1) Precedence of Banks

In Asia, banks are the major source of funds for companies, including small and medium enterprises. Banks are also the most important institutions that the general public entrusts with the management of their financial assets. Bank loans account for a very high proportion of finance by companies and, considering the current state of capital markets in the various countries, banks are expected to continuously serve as the main funding resources. Although East Asian capital markets have been showing gradual development, it will be awhile before they reach the stage in which the demand for financial assets in savings is varied and appears as a large flow into financial assets other than bank deposits, such as stocks and bonds, as is seen in the industrialized nations. In addition, compared to the infrastructure needed for banks, the infrastructure necessary for forming sound capital markets includes a wide range of market participants, such as issuing bodies, securities companies and analysts, investors, and supervisory institutions. Therefore, more time will be needed for their development.

Financial systems that are centered on banks assume a variety of risks, starting with the assumption of credit risk by the banks on behalf of their creditors, including their depositors. Banks form long-term business relationships by repeatedly providing financing for their clients. They also obtain internal information about the borrowers in the course of providing various services such as settlement systems. If necessary, they monitor the projects financed by their loans. In so doing, banks have made efforts to resolve the problems caused by the unevenness of the information about their creditors and debtors, and have played an intermediary role in financing. For example, even in Thailand, an Asian country that is considered to have a relatively advanced capital market, banks have by far the largest share of financing for companies. One reason for this, in addition to the above, is that the owners and managers of group companies are reluctant to divulge internal information about their business to the tax authorities and other external third parties, so their dependence on financing by the banks comes with a strong incentive to avoid public disclosure of information about their management and financial situations. In many cases, banks do not merely function as commercial banks, but exert wide influence on the whole financial market by also acting as institutional investors in capital markets, underwriters of securities, and issuers of bank debentures. Other characteristics include the fact that state-owned commercial banks hold a large share of the loan market in many countries, the existence of large business conglomerates, and the fact that many of these conglomerates manage banks as their financial divisions.

2) Roles of Foreign Banks and Foreign Capital

Financial liberalization took place in Asian countries to support the activities of foreign-affiliated companies in conjunction with policies for industrialization led by foreign capital, and the entry of foreign banks progressed to a certain extent. Under the WTO system, which was launched in 1995, member countries promised to deregulate financial markets according to the General Agreement on Trade in Services (GATS). Pressure to fulfill this commitment was a factor promoting the rapid opening of financial markets. Foreign banks mediated an international flow of funds to supplement immature domestic financial sectors, contributing to economic development. However, it is notable that the activities of foreign banks and foreign- affiliated companies did not lead to mutually complementary development in the domestic financial sectors and the real economy.

At first when policies were put forward to advance industrial structures with the introduction of foreign-affiliated companies, the capital which flowed in from abroad following the advance of financial liberalization was used efficiently in the economy as a whole, and this bore fruit in the form of productive investment. However, although the domestic savings ratio was raised owing to economic development, domestic capital tended to be concentrated in small accounts with a great deal of emphasis on shorter-term and safer investments. The domestic financial system's capability of supplying long-term capital remained immature, with the result that demand for the long-term funds needed for development became increasingly dependent on foreign capital. Along with the accumulation of wasteful financing, this became one factor behind the financial crisis.

3) Domestic Capital Lending

Since the financial crisis, the growth of bank lending has continued to be depressed. It remains stagnant in many countries, although growth has turned positive in some countries, including Malaysia and Korea. Meanwhile, deposits continue to increase, partly because depositors cannot find any other appropriate investment choices. Concerning bank loans, banks are still overwhelmingly making shorter-term rather than longer-term loans. In terms of the corporate and household sectors, a sense of excessive investment remains in the corporate sector, with slow growth in corporate finance because of a cautious approach to new capital investment, while consumer finance is showing better growth as there is a high level of demand for funds to purchase durable consumer goods, etc., due in part to lower interest rates and the spread of credit cards. It is reported that at many banks, consumer finance is making up for the depressed state of corporate finance and is serving as the source of profits for the time being.

(3) Bank Monitoring and Supervision

One factor behind the Asian financial crisis was the fact that rapid liberalization of the banking sector occurred before the government authorities had fully established the functions of monitoring and supervising the banks. Since the financial crisis, each country has been rapidly introducing global monitoring and supervision systems and standards, taking the advice of the IMF and World Bank. However, the reality is, actual practice has been unable to keep up with the framework of the new regulations and systems.

With regard to the monitoring and supervision of banks, the Basel Committee on Banking Supervision and various other international forums have prepared rules concerning financial regulation and supervision. These include the Basel Committee's 25 principles for bank supervision, the capital asset agreement established in 1988, and the New Basel Capital Accord that replaced the 1988 agreement. The introduction of international standards and codes, as seen in the ROSCs, is also being promoted, with the IMF at the center of such efforts. However, concerning banks' internal risk management capabilities, etc., upon which the application of global standards is based, the Asian financial sector is still behind the times, and there is a need to improve the business rules that relate international standards to the actual state of business practices.

Monitoring and supervising with the goal of developing sounder banks, along with the reorganization and strengthening of the banks, is an important matter for the banking sector as a whole, along with other issues facing banks such as disposal of NPLs and the credit squeeze.

For example, in 1999 the Asian Development Bank (ADB) stressed the following four policy issues from the standpoint of reforming the Asian banking sector: 1) liberalization of regulations on bank activities (abolishing interest regulations, relaxing restrictions on entry by banks, etc.); 2) disposal of NPLs (promoting the restructuring of NPLs, etc.); 3) strengthening prudential regulations and supervision (promoting risk management, market discipline, and the conformity of prudential regulations to international standards, etc.); and 4) stressing bank-related infrastructure (deposit insurance systems, better bankruptcy laws, etc.) and human resource training.

2.2 Current Situation and Issues Facing Asia's Banking Sector

(1) Disposal of Non-Performing Loans

Disposal of the non-performing loans held by commercial banks is a major issue in urgent need of resolution. As a result of efforts to address this issue by each country, the ratio of NPLs in the balance sheet shown significant improvement from peak levels in nearly every country. However, the main reason for the reduction NPLs ratios has been the transferal of large amounts of NPLs to asset management corporations or companies (AMC) and the like, removing this debt from banks' balance sheets. The practice of transferring NPLs to asset management companies established by the government has come under criticism for the lack of transparency in the transferal process and the subsequent handling, as well as the slow speed of disposal.[3]

Large amounts of NPLs weaken the financial basis of a bank, with the aftereffect of paralyzing a bank's ability to supply funds to companies. Since the financial crisis, strict loan management has been introduced rapidly in some countries, and lending activity has become stagnant. In Indonesia, which used government bonds to infuse capital into large commercial banks, banks are not merely content with the profit from government bonds having a risk weight of 0% based on the capital adequacy ratio (CAR), they are also investing most of the funds obtained from deposits in central bank bonds that can be

[3] In Thailand and some other countries, for example, an NPL is sold to asset management companies at net book value (book value minus allowances), and when the restructuring of the NPL progresses, it is thought that the asset management companies will be left holding only NPLs that will be difficult to dispose of, incurring greater losses than expected and placing a heavy burden on the government. Meanwhile, concerning the NPLs remaining on the banks' balance sheets, although a certain amount of progress has been seen in the disposal of debt with relatively good collectability, it is reported that the disposal of more complex debt remains to be addressed in the future.

considered as sovereign risk, with the result that hardly any capital is available for loans to companies.

Also, since the disposal of NPLs has not been completed, debtors are restricted from taking out new loans even if they have a business with development potential. And since banks reduced the number of borrowers to whom they lend money, this has the effect of choking off the potential for recovery of loan performance. In Thailand, many banks reduced the amount of NPLs in terms of accounting by casually extending debt settlement periods, and it is feared that restructured debt and loans with forgiven or reduced interest will again emerge as NPLs at these banks.

The disposal of NPLs is restricted not only by the recovery targets set by governments. For example, the bad debt collection activities of asset management companies are influenced by political trends. In some cases, the smooth disposal of failed companies is hampered by peripheral considerations such as industrial policy and employment issues, along with the insufficient capability of the courts to execute secured loans.

(2) Credit Analysis System

Part of the reason for the occurrence of NPLs is that the risk management capabilities at the banks, such as credit analysis and loan management, have not kept up with real economic growth and the accompanying speed of increase in the demand for capital, with the result that loan assets turn into non-performing loans.

In addition, banks still do not have enough expert loan officers. In the past, banks strove for quantitative expansion without first establishing a clear lending policy, and they extended loans without adequate credit analysis, lending on the basis of security alone in many cases. Therefore, they have not developed the necessary capabilities for credit analysis. As a result, the internal rating skills and credit lending skills of the banks remain poor, and they are not extending loans even if they have liquidity.

Another major obstacle is the lack of proper financial information on companies. Except for some listed companies and the like, it is very difficult to expect most companies to promptly provide accurate financial information; and this is a major reason why banks have to maintain a cautious stance on lending. Small and medium enterprises in particular, they are apt to avoid preparing the financial statements required under commercial or corporate law or providing the information that is really needed for a credit analysis. The main reason for this is that the necessary systems have not been established to efficiently enforce tax law, securities exchange law, corporate law, etc., with regard to financial statements. (See Chapter 6 for a detailed discussion on this point.) In addition, if the application of punitive provisions under the judicial system for circulating false information is lax, then it is difficult to obtain accurate information based on voluntary disclosure.

In addition, banks have gone beyond the scope of pure commercial banking activities in many cases, playing a role in favor of governmental development policy; and it was not unusual for the financial institutions affiliated with business conglomerates to position themselves as the financial department of the group. Therefore, banks have not necessarily been in the position to adequately conduct strict credit analysis and monitoring.

(3) Bank Supervision and Regulation

Following the difficult experience of the financial crisis, each country has taken serious steps to improve the supervision and regulation of banks. As the banking sectors of each country continue to incorporate international frameworks in light of growing financial globalization, there has been progress in the establishment of supervisory systems and regulations based on international standards. However, the following issues remain.

1) Administrative Regulation of Banks

(i) Effectiveness of Regulations

In the efforts of supervisory authorities concerning the regulation of banks, some of the regulations themselves have shown inconsistencies, including the promulgation of regulations and rules that seemed to reverse some effects that were the initial goals. For example, the Bank Secrecy Law of the Philippines has loopholes that actually make inactive the prohibition of loans based on personal connections; and questions have emerged concerning the rapid introduction of the internal risk assessment model. In Indonesia, while the government is deeply concerned that private companies are not able to obtain finance, it gave banks a target for very rapid improvement in the CAR and NPL ratios, resulting in slower growth in bank lending. In China as well, official regulatory notices concerning lending are hampering bank activities. In some countries, non-banks are gradually carrying greater weight as a result of deregulation, and even if supervision is strengthened with regard to lending by banks, companies that have a non-bank in their corporate group can still find a way out.

(ii) Appropriateness of Regulations

Global standards, promoted by the IMF and the Basel Committee, form the core of regulations and systems established by bank supervisory authorities. However, there is a great deal of criticism from the banking industry concerning the appropriateness of government policy, to the effect that new measures are being implemented too rapidly for the bank systems to catch up, or economic repercussions are not being taken into consideration. Since the goals of ensuring sound banks and expanding lending are contradictory propositions, the issue of balanced policy administration remains unresolved. More fundamentally, even in the current environment, in which banks are still owned by a few large shareholders and dependent on the same executive teams as before, even as questions of management responsibility are raised, there are still areas in need of improvement in the regulations and the approach to detailed monitoring and supervision, in order to more effectively improve the soundness of the banks.

(iii) Supervisory and Regulatory Capabilities

Although the governments have enacted many new regulations and issued plans for monitoring and supervision, in many cases they have not allocated sufficient organizational and personnel resources to implement these regulations and plans. Little care has been taken to improve the capabilities of supervisors and inspectors, including their years of experience and skill levels; and they have not been given sufficient incentives to perform their inspection duties in a serious and thorough manner.

There are cases of supervision and guidance that only increase the burden on banks. For example, in the guidelines issued by bank supervisory authorities, compliance inspections are left to internal inspections by the banks. The authorities' actual on-site inspections, however, follow basically the same inspections unless there is any particular reason not to do so. And often, government agencies do not cooperate smoothly with each other concerning the supervision of financial institutions. There are still many areas in need of improvement with regard to supervision and methods of inspection.

(iv) Building a Competitive Environment

For sound bank supervision, it is necessary for problem banks to withdraw from the market, based on the principle of 'survival of the fittest.' However, sufficient measures have not yet been implemented to facilitate the disposal of problem banks. In nearly all countries, there is no cap on deposit insurance or payoffs, and deposits are protected for their full amounts. As a result, no competitive environment has developed for banks, and there is still persistent anxiety concerning a moral hazard. Another important issue for the future is the introduction of deposit insurance systems in Asia.

(v) Response to International Banking Activities

Along with economic globalization, large local financial institutions have begun a wide range of business activities that transcend national borders, and foreign banks that have entered Asian markets are gradually becoming more influential in the domestic markets. In these and other ways, international interdependence is growing in the banking sector, while the supervisory authorities still lack a sufficient understanding of the situations of financial institutions on an integrated, international basis.

2) Market Discipline

(i) Autonomous Corporate Governance

To maintain safety and soundness in the banking system, it is desirable that synergistic effects be produced by the effective functioning of market discipline, supervision, and business management on the part of the banks themselves. For management by the banks themselves, it is necessary to actively promote the disclosure of information while ensuring governance in the administration and financial matters of banks. However, looking at the ownership structure of the banks, many powerful banks are either banks of certain business conglomerates or state-run banks, so these banks are not in a position for adequate functioning of corporate governance by the banks themselves. In the case of a business conglomerate's bank, the bank and the lenders are essentially the same entity, so the collective survival of the group companies tends to be given a high priority, and there is resistance by the bank to autonomous governance. And in the case of a state-run bank, the administrators tend to put off dealing with problems and to be strongly oriented toward financing that is based on government policies.

(ii) Disclosure of Information

In each country, for some time already, there has been an awareness of the need to obtain more thorough disclosure of information concerning the administration, finances, and assets of banks, and to promote market competition. However, thorough steps have not been taken. To ensure reliability in banking, it is essential to establish sound bank accounting standards and ensure information disclosure. Urgent measures are needed in this regard.

(4) *Restructuring and Strengthening the Banking Industry*[4]

1) Scale of Banks

Although bank reorganization has been making progress in Asian countries, banks have not yet reached a sufficient scale. For example, banks in the Philippines are no more than a third the size of the largest banks in its neighboring countries. It is necessary to take steps to strengthen banks, including improvement in their financial resources, based on clarification of the roles that banks should play in the future.

2) Participation of Foreign Capital

Although financial liberalization was being promoted in each country before the crisis, there were many restrictions. Since the crisis, each Asian country except Malaysia has begun inviting foreign banks to help with the disposal of failed banks. In this environment, foreign banks have obtained branch networks by purchasing local banks, entering the retail market, and increasingly competing for customers with other local banks. However, foreign banks have generally taken a passive attitude to market entry, and there is emerging opposition among the general public to the rehabilitation of problem banks using foreign capital. The progress of bank rehabilitation is slowing down.

3) Exit Policy

There are cases in which thorough measures cannot be taken because of the lack of an exit policy to promote smooth bank reorganization. In Indonesia, a great deal of social unrest resulted from the announcement of bank closures in the past. In some cases of privatization of nationalized banks, there has been a failure to take any fundamental measures; the banks are privatized while still retaining their NPLs and the employees are simply transferred.

To resolve these issues, the governments will need to show strong leadership.

2.3 Assistance

(1) *World Bank*

1) Basic Stance on Assistance

Asian countries are recovering rapidly from the financial crisis, and the nature of support to East Asia has changed significantly from its initial form. The outstanding balance of emergency assistance loans as support for recovery from the financial crisis is much lower than its level at the time of the crisis, and there has instead been an increase of services such as analysis and advisory services. The weakness of the financial sector and its infrastructure has been indicated as one cause of the Asian crisis, and in 1999, the

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[4] A vision of how to deal with banks should be at the forefront of efforts to strengthen the banking sector. This vision should also address the role of foreign banks and the future functioning of local banks.

Although bank reorganization is making some progress, it is necessary to devise an approach concerning such issues as the expansion of banks to an appropriate scale and procedures for the entry of foreign banks, and to implement that approach in a planned manner toward the creation of more concentrated core banks in the progress toward international financial reorganization.

To realize more efficient asset allocation on a macro basis for the financial sector as a whole, rather than merely focusing on management efficiency from the micro standpoint of individual financial institutions, it is essential to achieve improvement in fundamental problems such as the lack of transparency in informational structures, the backwardness of ownership and management form, the lack of adequate financial resources, and the low level of financial technology. These kinds of problems stimulate not only sounder management of financial institutions alone, but also an active financial administration that takes the reorganization of the financial industry into consideration as well. It is important to study this issue as a kind of industrial policy perspective with the goal of nurturing and strengthening local financial institutions. The model policy has already been formulated for the manufacturing industry.

World Bank provided a great deal of support aimed at establishing a strong financial sector with adequate controls, a long-term bond market, and internationally recognized accounting and auditing standards. The stance is still to support prudent macroeconomic administration for stable economic development. However, the emphasis is shifting toward restructuring financial institutions and companies, strengthening corporate governance, improving performance and governance in the public sector, and protecting the weak members of society.[5]

Along with changes in the content of World Bank's support for the banking sector in East Asia, the main recipient countries of its support are changing. The emphasis is shifting from Thailand and Indonesia, which were the epicenters of the financial crisis, to China, a new member of the WTO.

2) World Bank's Major Loans Related to Technical Assistance (TA) in East Asia

When Approved	Period	Recipient Country	Content of Support
August 2000	NA	China	TA for financial sector (details unknown)
December 1997	May 2001	Indonesia	TA for financial sector (details unknown)
September 1997	September 2003	Thailand	Main purpose: TA for liquidation of finance companies. 1. Strengthening procedures for the liquidation of financial institutions, and discovering potential problem banks. 2. Rationalizing the supervision of financial institutions, strengthening market discipline, strengthening auction procedures for bankruptcy and auctioning of securities, and structural reform of the financial infrastructure.
November 1995	December 2003	Vietnam	Main purpose: TA for modernization of financial sector to meet the needs of economic development. 1. Improvement of the payment system and greater convenience in remittances. 2. Strengthening of organizational incentives for participating banks to improve internal management and customer service.
September 1992	September 2002	China	1. Modernization of the domestic payment and exchange system. 2. Improvement in the following functions of the central bank in China: Monitoring and supervision of the financial sector, accounting and internal audits, and investigation and statistics.

3) Assistance Policies for Specific Countries

(i) Indonesia

The Country Assistance Strategy (CAS) for 2001-2003 is based on the three pillars of poverty reduction, good governance, and economic restructuring. Support for the financial sector constitutes support for the establishment of sound functions within the framework. The World Bank supports economic restructuring along with the IMF, based on the concept that continuous economic growth is essential for poverty reduction and the promotion of bank and business restructuring. In 1999 and 2001, the World Bank provided support for state-owned banks and measures to restructure financial institutions and corporations. The purpose was to build an institutional- and policy-based environment to attract private investment.

[5] At present, World Bank's greatest aim is to support measures for the poverty reduction, and the support for sustainable economic development is positioned as a means of achieving that goal.

(ii) Thailand

One reason behind Thailand's decline in productivity, said to be an indirect cause of the crisis, was government policies that resulted in provoking imprudent behavior by banks and non-banks without reflecting on profitability. After the crisis, the World Bank provided support for the Thai government to promote prudent behavior by banks and non-banks and to switch to a policy structure that would provide effectively functioning controls. To further promote movement in this direction, the World Bank cooperated with international organizations such as the ADB and the United Nations Industrial Development Organization (UNIDO), in addition to the Thai government, in preparing "Country Development, Partnership for Competitiveness" (2001). The World Bank is working to strengthen competitiveness through the promotion of comprehensive reform in financial institutions, in concert with Thailand's Ninth Economic and Social Development Plan.

- **Reform of Thailand's Financial Institutions**

  Short-Term Goals:

  (1) Measures for transition to the across-the-board application of Bank for International Settlements (BIS) regulations and international standards on loan loss and security

  (2) Revision of the public assistance plan to infuse capital into private banks, and implementation of the Thai Asset Management Company (TAMC)

  (3) Disposal of NPLs held by state-run banks

  Medium and Long-Term Goals:

  (1) Further strengthening of banking sector

  (2) Introduction of deposit insurance

  (3) Risk-based supervision

  (4) Reorganization of government bond distribution network

- **Technical Assistance by the World Bank**

  (1) Disposal of assets from failed banks and assets from banks subject to intervention by TAMC or the government

  (2) Capital infusion and strengthening core state-owned and private banks

  (3) Encouraging the market for bank stock and assets (including NPLs) by the sale of assets that have come under state control in a planned manner, in addition to increasing the overall transparency of losses

  (4) Strengthening of rating agencies, credit bureau, AMC, and other core institutions

(iii) Malaysia

To support the reorganization of the corporate and financial sectors as promoted by the government, the World Bank provided a $2.7 million grant for Policy and Human Resource Development (PHRD) in 1999, and gave support for the government's AMC and Corporate Debt Restructuring Committee. The World Bank also supported administration and management of the Asia-Europe Meeting (ASEM) TA Grant involving the Central Bank of Malaysia (BNM), as well as the designing and implementation of a customer early-warning system in the banking sector.

(iv) Philippines

There was relatively little impact from the financial crisis that struck Asia. In 1999, World Bank provided support for building a banking system that could withstand the current situation and future shocks, in the form of TA for monitoring and reorganizing in the Banking System Reform Project. The World Bank also supports financial institution and corporate restructuring activities through Consultative Group Meetings.

(v) China

In 1999, the World Bank supported reform of the state-owned commercial banks.

(vi) Other

In Vietnam, the World Bank provided a new Poverty Reduction Support Credit as a means of comprehensive support to attract private investment, and supported structural reforms to strengthen the transparency and accountability of state-owned companies and public financing by banks.

(2) Asian Development Bank

1) Basic Stance on Assistance

The content of support that the Asian Development Bank is providing to East Asia has also undergone significant changes, as in the case of the World Bank. Shifting away from its former emphasis on emergency financing, it is increasing the amount of financial structural analysis and advisory services.[6] The basic mode of assistance is TA, while coordinating the policies and areas of support with the World Bank, the IMF, etc. Based on the understanding that sustainable economic development is an essential condition for strengthening the financial sector, TA is provided in a manner suited to the actual circumstances of each country.

Therefore, the content of the support is widely varied, from large-scale reform to minor reform. This diversity is also suggested by the number of recipients and the amounts spent on consultation or implementation, as shown in the table below, entitled "Uncompensated Technical Assistance by the Asian Development Bank."

[6] A poverty reduction strategy was adopted in 1999. Implementation of this policy began in 2000, based on the three pillars of good governance, social development, and sustainable economic development to benefit the poor.

2) Uncompensated Technical Assistance by the Asian Development Bank (ADB)

Year and Recipient Country	Program	Amount for Consultation or Execution
1999		
Cambodia	Development of capabilities for financial services in rural villages	1,450
Indonesia	Development of a deposit insurance system	150
Kyrgyzstan	Organizational strengthening of the financial sector	600
Mongolia	Strengthening reorganization of the banking system	220
Nepal	Establishing bases for reform of the financial sector	150
Philippines	Development of a non-bank financial sector	2,000
Thailand	Reorganization of specialized financial institutions	3,000
Uzbekistan	Strengthening the banking sector	1,000
Vietnam	Strengthening corporate governance in the Vietnam Bank for Agriculture and Rural Development	900
2000		
Bhutan	Project assessment and portfolio management by financial institutions	400
China	Development of a credit assistance program for small and medium enterprises	750
	Strengthening the programs of the China Development Bank	600
	Development of policies and mechanisms to extend loans to small and medium enterprises	700
Fiji Islands	Review of the Fiji Islands Development Bank	150
India	Improvement of lending capabilities of the Housing and Urban Development Corporation with regard to local financial institutions	150
Laos	Strengthening corporate governance and monetary aspects of state-owned commercial banks	900
Mongolia	Strengthening development of the financial sector	600
Samoa	Developing the capabilities of financial and business consultative organs	500
Tajikistan	Support for development of a financial system for a rural district	150
2001		
Azerbaijan	Seminars on measures and procedures for bank operations	150
Bangladesh	Review and establishment of strategies for financial, industrial, and trade sectors	125
Bhutan	Review of the financial sector	300
Cambodia	Capacity building for management of bank and financial institution	1,000
India	Effects of financial sector policy and reform on poverty reduction	150
Laos	Financial, lending, and economic advice	950
Pakistan	Strengthening programs of the State Bank of Pakistan	450

Unit: $1,000

3) Assistance Policies for Specific Countries

(i) Indonesia

A new Country Operational Strategy (COS) has been adopted, and the ADB is focusing on the long-term development of Indonesia in providing full-scale support with regard to the improvement of government governance, development of the private sector, human resource and social development, and environmental management. In the implementation of TA and loans in 2001, ADB shifted its emphasis from support for a continued economic recovery to support for the new COS goals. In the financial sector it is focusing on corporate governance. It is also offering advice on strengthening financial institutions in relation to a proposal for legislation to eliminate money laundering. Other support includes TA for strengthening the financial service supervisory institutions.

(ii) Thailand

Since 1997, ADB has continued to participate in policy talks with the IMF and the World Bank. The IMF holds principal responsibility and plays a central role in supporting the reform and strengthening the central bank, while World Bank is focusing on support for the reorganization and rationalization of non-bank financial institutions. Both the IMF and World Bank are cooperating in a joint effort to build a regulatory framework for banks and other private finance companies. Meanwhile, ADB has responsibility with regard to the reorganization and development of a capital market. In December 1999, ADB provided loans for the restructuring of four government-affiliated financial institutions. In addition, ADB has provided support to build a framework for the principle of corporate governance to ensure the independence, accountability, and transparency of government-affiliated financial institutions, and based on those results, ADB is also looking into the revitalization of financing for small and medium enterprises (SME) using government-affiliated financial institutions.

(iii) Malaysia

In 1999, hardly any support was provided other than TA for reorganization with the goal of strengthening the competitiveness and integration of financial institutions. In 2001, no programs were conducted, and no policy consultation was performed.

(iv) Philippines

Under TA related to the Country Strategy and Program, the ADB has supported the strengthening of non-bank financial institutions (Non Bank Financial Governance Program, 2001) and provided micro-finance support for regional development. The two areas of assistance in the financial sector are 1) support for the reorganization of financial institutions, particularly non-bank financial institutions, and 2) support for the restructuring of corporations and financial institutions to improve competitiveness.

(v) China

Most of the ADBs support in the financial area is related to small and medium enterprises. The three primary areas of support are 1) building a macro policy implementation environment for the development of loan mediation mechanisms aimed at small and medium enterprises, 2) developing measures of financing to enable small and medium enterprises to procure funds on the debt market (with cooperation from the municipal government of Shanghai), and 3) strengthening programs of the China Development Bank.

2.4 Points of Consideration and Future Directions for Assistance

(1) Recognition of Issues

In East Asia, banks play the most important role in financial mediation, and this is expected to continue in the future as a basic trend. East Asian countries have promoted financial liberalization policies while aiming for industrialization led by foreign capital. To strengthen this type of financial development, it is necessary to address three focal issues. The first is to strengthen the supervisory and regulatory framework of the financial sector. The second is to strengthen the management of local financial institutions. And the third is to build a system for capital transaction that allows the sound utilization of foreign capital.

The direction for resolving the first issue is rooted in self-responsibility, following the market-based regulatory approach. It is essential to ensure the transparency of information and market discipline based on market surveillance, and there is room for further improvement in this area. Second, with regard to the issue of stimulating and strengthening the management of local financial institutions, it will be necessary to take advantage of their capacity to absorb domestic capital, which is still strong compared to foreign banks, along with their provision of a domestic settlement system and capacity to supply capital to local companies, and as prerequisite of the above, the domestic branch network and domestic customer base. To achieve this, it will be necessary to strengthen monitoring functions and improve human resources and so on. Therefore, it is desirable to strengthen the infrastructure for bilateral banking operations as a first step. And with regard to the third issue, there is a need to apply market discipline based on the liberalization of foreign exchange and the principle of self- responsibility in trading, and to strengthen prudential regulations for banks to function appropriately as loan mediators. In industrialization led by foreign capital, premised on a global economy, a great deal is expected from the activities of foreign financial institutions; and by means of their activities, it is desirable to strengthen the four-way linkage of local companies, foreign companies, foreign financial institutions, and local financial institutions, to propagate expertise in bank management, risk management, and information production know-how, and to improve the efficiency of financial markets owing to the establishment of market discipline.

The purpose of bank regulation is to restrain financial activities that result in excessive risk taking, thereby preventing the deterioration of financial functions and contributing to industrial development. Banks expanded rapidly in the positive economic environment that continued for many years beginning in the latter half of the 1980s, and although some measures were in place to curb excessive expansion, these were not sufficient to prevent the financial crisis. Since the financial crisis, the World Bank, the IMF and other organizations have provided guidance and each country has made efforts to improve its banking sector, but many unresolved issues still remain. The following is a discussion of points to keep in mind with regard to support for recovery of the essential functions of financial institutions, based on an awareness of the above issues.

(2) Points of Consideration

The following are some points that should be kept in mind by Japan in providing assistance to the countries of East Asia.

First, it is important to have a clear awareness of the reasons for giving priority to improving the banking sector. It is not the case that the banking sector itself is naturally of a higher priority. Rather, considering that financial institutions must fulfill their functions to achieve continued economic development even when the infrastructure is poor in terms of accounting, legislation, information, etc., it is appropriate in realistic terms to give priority to improving the banking sector.

Similarly, with regard to prudential regulations, several types of regulations are considered necessary even after progress has been made in overall institutional development. It is wise, however, to more realistically choose regulations, considering that they should be easier to implement and inspect in a poor infrastructure, and they are minimally necessary to stabilize the financial system. Prudential regulations[7] are an option to be considered as the next best choice in order to achieve the goals that other regulations and systems would normally be able to achieve. Therefore a stricter benchmark for regulations comparable to international standards is advised.

Priority must be given to the support for banks in order to rapidly dispose of NPLs and to regain their strength. Keeping bank management sound and stimulating corporate finance for the sake of sustainable economic development depends greatly on the banks recovering their strength.

Banks have the social mission to fulfill smooth capital mediation and settlement functions, but they are also private, profit-making enterprises, and they need to obtain sound earnings for reinvestment. Therefore, the requirement of establishing stricter management controls and building systems will not be effective unless banks can perceive that these offer a future advantage; this should be noted in the case of assistance.

Since the World Bank, the IMF, and bilateral assistance programs by other countries are also providing support, Japan should concentrate on the issues it is currently addressing or has dealt with in the past, or on support for countermeasures. Concerning the content, Japan should focus on matters for which a wide range of human resources can be obtained and realistic advice for improvement can be given, and matters that will be easily acceptable to the recipient country.

(3) Issues and Future Directions for Assistance

In providing assistance, Japan needs to keep the above points in mind and act on the basis of its past institutional experience as well as on the situation of its human resources.

1) Approach

In the future, when providing assistance for institutional development, it will be necessary to face up to the urgent issues in each East Asian country and take a highly effective approach that is suited to the stage of development of each country. It is advisable for Japan to pursue assistance from the standpoint of those working on the front lines of bank operations, bank monitoring and supervision, and infrastructure

[7] As the infrastructure surrounding banks remains inadequate, prudential regulations, mainly for monitoring and supervising banks, will be the key to achieving the greatest possible improvement in the loan mediation function of banks. The selective utilization of prudential regulations can serve to supplement market discipline.
(1) For example, the revised Basel regulations (CAR) are based on autonomous risk management by banks, and if they have a low capability in this regard, uncritical introduction of regulations is risky. To prevent the recurrence of unproductive financial activities, one possible step would be to apply a clearly understandable capital adequacy ratio (for example, requiring CARs of over 8%).
(2) Although it is desirable to reform the structure in which financial institutions are owned by specific families, this cannot be achieved immediately. To obtain appropriate risk management by banks, in addition to regulations on large-scale loans and single customer limits, it is effective to avoid excessive risk concentration by introducing lending regulations for loans to companies in the same industry as major companies of the group to which bank belongs, or in related industry types that would tend to be easily influenced, similar to industry based lending regulations, for example.
(3) If it is difficult for a financial institution to monitor companies within the same group and exert influence for improvement, it is necessary to introduce formal monitoring by the bank and then have inspections conducted by an authority concerning the bank's performance of monitoring in order to improve the actual effectiveness of monitoring. Another possibility is for the government agencies that supervise banks to provide guidance on a compulsory augmentation of the risk weighting in CAR calculations with regard to companies that fail to submit adequate financial statements.

development. The reason is that Japan has experience in building its current systems through a process of consistently learning from Western systems and conforming them to its own changing domestic situation. Japan is the only country that is equipped to make concrete, specific comparisons between a country that had plenty of time to conform these systems to its own domestic circumstances and a country, such as Asian countries, which have not had so much time.

2) Assistance Procedures

In each country, the banks' reluctance to lend and the disposal of large amounts of NPLs are major issues facing banks. First, to expand lending, it is important to provide cooperation to improve banks' credit analysis capabilities and build databases of information on companies. In addition, cooperation for a policy-based credit guarantee system is also effective.

Other possible assistance options include building a settlement system, which is part of the basic infrastructure to establish a sound banking system, and promoting bank monitoring and supervision and the disposal of NPLs as essential issues.

In any case, it is important to provide support that will lead to the establishment of systems, by aiming for modularization of the technical aspects in technology transfer assistance, and jointly seeking political solutions through dialogue, joint research, and other measures.

3) Assistance for Banks

(i) Promoting Debt Disposal

Inadequate legislation is one reason for the lack of progress in debt disposal. This must be handled differently according to the political and economic situation of the country in question. However, unless progress is made in dealing with companies bearing NPLs, there will be an obstacle to economic development in that country, so this is an important issue. In the processing of disputes related to debt and in the conversion of debt to stock, along with improvement in the capabilities of commercial courts, it is also useful to share Japan's experiences and transfer its knowledge concerning the steps that are currently needed in the country in question, such as the introduction of mechanisms for alternative dispute resolution (ADR); and to conduct joint research on future measures.

(ii) Improving Credit Analysis for Loans

It is necessary to combine and implement a variety of approaches in a credit analysis, based on the actual situation of a company. Both for loan officers and for the officers in charge of the business partner, it is essential to develop the ability to discern the company's growth potential and business situation. For loans to small and medium enterprises [8] in particular, practical cooperation could be provided toward the introduction of diverse credit analysis skills such as loan pricing methods, security valuation, and interest rate setting.

It is also important to cooperate in the preparation of credit analysis manuals and the like, through collaboration with financial assistance agencies. Along with cooperation, it

[8] In Malaysia, the government promotes financing for small and medium enterprises in a compulsory manner. Bank Negara, the central bank, allocates a minimum target amount for each bank to lend to small and medium businesses, and if the bank fails to achieve the target, the remainder is to be deposited at the central bank as a legal reserve requirement, a kind of penalty.

is desirable to provide support for a corporate accounting system, as described in Chapter 4.

(iii) Strengthening Risk Management Systems

A wide range of cooperation through seminars, etc., is being conducted by international financial institutions, central banks, and other agencies with regard to the development of tools and new theories on risk management, including assets and liabilities management (ALM), rating systems, and early warning systems.

This field is largely dependent on cooperation with the private sector, but it is also necessary to pursue the sharing of information on risk management methods with central banks and bank supervisors.

Other skills for loan follow-up management, such as monitoring[9], are being acquired, but further advanced education is needed for an essential understanding of the interplay among risk factors, including exchange fluctuations and liquidity risk. Asset classification for existing loans should also be pursued more strictly. Support in these practical fields is worthy of consideration as well.

4) Assistance for Government Agencies that Supervise Banks

(i) Improving Bank Monitoring and Supervision Systems

With regard to the capital adequacy ratio (CAR) of banks, there is an urgent need for institutional developments based on international trends, through advancing the revision of regulations with greater respect for self management and market discipline, encouraging the use of ROSCs and the Basel Core Principles, etc. However, appropriate formats should be chosen for bank monitoring and supervision systems according to the situation of each country. An example would be applying prudential regulations and strengthening their content according to the actual situation of each country. Considering the situation in which banks are substantially owned by specific business groups or major shareholders, several methods would be introduced, such as changing the proportions for large-scale lending rules and single customer lending limits depending on the bank's ownership format, or introducing detailed control of the loan’s outstanding balance for sectors such as real estate, securities, etc., to which the business groups or major shareholders belong. Therefore, among the various policymakers in each country, it is important to promote the mutual exchange of views concerning issues faced by the supervisory authorities, as well as the exchange of information among these supervisory authorities with regard to human resource development. It would be effective to hold seminars for persons involved in bank supervisory agencies or provide support for the preparation of inspection manuals, etc., according to the needs of the country in question.

Concerning cooperation in this field, it is also valuable to strengthen collaboration and establish venues for sharing information among Asian countries and exchanging information from perspectives such as the discussion of future approaches, and to form joint research programs in specialized fields.

For example, progress in economic and financial standardization would result in the culling out of banks, and exit policies would be important. Possible research topics would include what sorts of market entry policies should be adopted and what sorts of

[9] In Thailand, for more effective monitoring, borrowers are required to submit data concerning their own company's business situation (income and expenditure reports, business strategies, and situation of loans and other debts) to the bank at regular intervals. If the borrower fails to submit this data, the bank has the clear right to stop the loan.

mechanisms should be prepared for the withdrawal of financial institutions that do not conform to the market.

Government Regulations and Supervision:

Governments should implement a variety of regulations and supervision, and the individual support to be provided should be appropriate for the actual situation of each country. The following are some basic possibilities:

(1) Gradually eliminate government intervention in bank management (including regulations on policy and program financing) in order to promote sound bank development and establish a system by which banks can smoothly carry out their functions.

(2) At the same time, differentiate ownership structures to avoid excessive commitment to specific business groups, introduce outside executives, and build professionalism in bank operations.

(3) Concerning bank monitoring and supervision, build systems for the implementation of appropriate regulations based on global trends, including the Basel Core Principles.

(4) Improve executive capabilities as important elements of monitoring and supervision agencies.

  (i) It is necessary to ensure flexible organizations with the necessary human resources for efficient execution, and to improve the evaluation and compensation of inspectors engaged in bank auditing and guidance.

  (ii) Since new financial products are always being developed and progress is always being made in financial technologies in advanced countries and elsewhere, inspectors need to continually acquire new knowledge and refine their inspection skills.

  (iii) Obtaining outstanding inspectors is an important issue for developing countries. Therefore, along with improvement in the training of inspectors, it is necessary to clarify directions for monitoring and supervision systems, including determining items of priority in consideration of rules based on market mechanisms and the utilization of audit corporation.

5) Infrastructure Development

(i) Corporate Information Databases

Along with the introduction of cash flow based credit analysis, which has become the norm in recent years, the role of business information data has become more significant. In Japan, the banks' main sources of business information are credit information from Teikoku Databank, etc., together with information from clearinghouses on dishonored checks. Many banks also collect information themselves on the companies that mainly bank with them. In other Asian countries, there is no system to collect business information in an organized manner, but the governments are leading efforts to build databases with customer data to be shared among banks. First, assistance for this movement could be provided by supporting the establishment of common databases with the minimum of necessary information for credit analysis, based on the banks' data concerning their borrowers. To link this common database with the databases built independently by individual banks, the skills developed by Japanese banks for use with their customer data files could be shared. Specific areas of assistance could include support for system design and the establishment of a database, or support in training human resources for database operation.

In the medium to long term, research will be needed on appropriate approaches for establishing independent databases of business information, comparing with the situations in other foreign countries.

For collecting this kind of business information data, it is also necessary to establish measures to prevent the abuse of customer data by other banks or third parties, as well as measures to ensure that the data is up-to-date and easy to use.

(ii) Credit Guarantee Systems

Even if credit analysis capabilities are improved and the proper environment is provided for business information databases, finance to small and medium enterprises is still exposed to a great deal of credit risk, so further policy support will be needed in many cases. Many countries of the world have introduced credit guarantee systems as a way to lessen bank risks. Credit guarantee systems are being expanded in Asian countries as well, and Japan's experience could be used in cooperation by sharing its expertise with regard to the coverage of credit guarantee and reinsurance systems. Specifically, assistance could include the holding of seminars, survey research for the establishment of credit guarantee systems, and training of human resources to manage such systems, with cooperation from the Japan Small and Medium Enterprise Corporation and Japan's credit guarantee corporations.

Note: Another way to expand lending would be the establishment of government banks. However, that will not be discussed here, since the focus of this report is on programs for the expansion of financing in the private sector.

(iii) Deposit Insurance Systems

Whether by market discipline or by administrative discipline, the rapid withdrawal of problem financial institutions from the market is necessary for reliable functioning. From the standpoint of market discipline, it is essential to establish mechanisms to improve the capabilities of commercial courts to promptly shut down failed financial institutions. From the standpoint of administrative discipline as well, it is necessary to minimize social costs by preventing the spread of economic damage. Therefore, it is necessary to build a safety net by expanding deposit insurance systems and improving insurance reserves. It would be useful to share Japan's knowledge gained through trial and error in this area, as well as its experience in building frameworks for corporate reorganization and consolidation in conjunction with the recent revision of the Commercial Code.

(iv) Settlement Systems

Bank settlement systems are the source of user trust in the banks, and their settlement functions are as important as their loan mediation functions. As companies conduct their daily business with banks, the banks can gather information on the operational situations of companies based on the movement of funds. Settlement systems are being improved in Asian countries, however in countries with transitional economies, longer time periods are required for bank settlements, and this is risky for companies. To reduce risk for their activities, it is important to provide assistance for the establishment of systems for prompt settlement. Even in countries that are already working on the introduction of new settlement systems, such as real-time gross settlement (RTGS), there is always a demand for updating these with new systems.

The Bank of Japan is providing assistance to Thailand, China, and other countries for the establishment of settlement systems at central banks, and exchanging information on new systems. Possible future areas of assistance include the sharing of information concerning these settlement systems and cooperation in surveys and funding for system introduction.

(v) Other Infrastructure Developments

Improvements in the legislative system are needed, including the enhancement of bankruptcy laws and the promotion of the disclosure of information on borrower businesses, as well as a regulatory framework for sound financial institutions. If this institutional infrastructure continues to be inadequate while regulations are strengthened for the transparency and soundness of bank operations only, industrial lending could shrink and there could be excessive dependence of banks on shorter-term commercial loans and consumer loans. These issues will be discussed in detail in Chapter 6.

Chapter 3: Capital Markets

3.1 Situation of Capital Markets

(1) Trends in International Capital Markets

Capital markets have generally stabilized since the Asian crisis, although various issues remain unresolved. There is increasing access from many emerging markets to international capital markets, while the premiums on bonds issued by emerging market countries are declining. From a short-term perspective, threats to the stability of international capital markets are waning. However, following the revelation of improprieties at Enron and that company's subsequent collapse in the U.S., a country that has placed a good deal of emphasis on corporate accounting systems and corporate governance, confidence has been shaken in the announcements of corporate earnings , and international capital markets have been seriously affected. Market reactions have been severe, with stock prices declining sharply when earnings are considered to be the result of dubious accounting practices. Therefore, it is urgently necessary for companies to respond appropriately, including accounting transparency and proper corporate governance, in addition to their prior emphasis on stronger profits.

A great deal of the world's investment capital is currently being moved across national borders in search of better investment opportunities. Investment capital is also flowing into the markets of developing countries from abroad. The development of domestic capital markets will allow companies to obtain investment funds from both domestic and international sources.

While this international movement of funds is causing an emerging market boom, it is also carrying risks of price manipulation from abroad in the markets of developing countries. International cooperation is needed in market regulation and supervision.

Role of Capital Markets:

As capital markets develop, there is dramatic expansion in the scope of capital strategies available to companies. In particular, stock markets allow companies to procure capital even if they lack sufficient collateral to guarantee credit as long as investors consider them to have high potential for growth, because stock markets attract investors who are looking to profit mainly from increases in share prices.

The first criterion for capital market development is to ensure a sound market. The following conditions are needed for the development of a sound market.

(1) Fair Trade

Trading in a capital market must be fair. Markets with widespread unfair trading practices that benefit only certain investors, such as insider trading, will lose investors' confidence and fail to develop smoothly. It is important to monitor markets to ensure that trading is fair, and to penalize unfair trading.

(2) Business Management Systems at Listed Companies

Since listed companies gather investment capital from the general public, it is important to establish and improve business management systems. Safeguards are needed to ensure that only companies with appropriate accounting systems and modern, rational business management can become listed, and strict analysis must be required for listing.

(3) Disclosure

Since investors bear the investment risk in capital markets, corporations are responsible for disclosing business information to investors. Public corporations must promptly announce important matters concerning their business, including corporate performance, revised earnings estimates, and business alliances. The disclosure of corporate information is a necessary condition for sound market development.

(4) Ensuring Shareholder Rights

Stocks are equity certificates issued by joint-stock companies to their investors (shareholders). Shareholders have rights with regard to their own economic interests (personal interest rights) and rights with regard to participation in the management of the company (common interest rights). For stock market development, these shareholders' rights must be protected.

Maintaining a high level of soundness is a precondition for capital markets. But for further market stimulation, it is necessary to take practical steps for the primary and secondary markets, such as the relaxation of regulations and conditions on the issuance of stocks and bonds, improvement of settlement and trading systems, and the development of brokers.

(2) Characteristics of Asian Markets

Although there has been some increase in financing through bond markets and stock markets since the Asian crisis, capital markets and the bond market in particular still cannot be termed well-developed. There are four major reasons for this: 1) low volumes of issuance and low outstanding balances, 2) low liquidity in secondary markets, 3) predominant concentration to short terms maturity, and 4) small investor bases.

Still, in terms of the overall financial structure, it is true that capital markets are gradually developing in Indonesia, Korea, Thailand, Malaysia, and other countries. As a result of the long period of economic growth that began in the late 1980s, incomes in the household sector have increased and a small shift in financial assets has begun, away from total reliance on bank deposits and toward pensions, insurance, and other financial assets. This led to the beginnings of investment in capital markets by institutional investors. However, household incomes are still low and cannot provide risk money, while the lack of investment expertise among institutional investors, undeveloped state of capital markets, and large amounts of regulations keep most capital deposited in bank accounts, etc.

This overwhelming strength for capital absorption on the part of banks means that banks play a central role in capital markets. In addition to the strengths of banks, which include capital volume, reputation, and capacity for collecting information and monitoring, banks are seeking to enter capital markets in order to obtain the additional advantages of making up for lowered profitability due to intensifying competition in the banking sector and utilizing economies of scale and scope. However, it is expected that a variety of institutional investors will emerge in Asia along with rising incomes, and the amounts to be invested will also gradually increase. Institutional development will need to match the characteristics of the relevant stage of development.

3.2 Conditions and Issues of Capital Markets

Since the financial crisis, there has been a growing perception that capital markets should be developed rapidly as a new mode of corporate financing, in addition to bank loans. Each country has been making efforts to develop its capital markets with guidance from the IMF and the World Bank. However, some unresolved issues remain for the development of sound capital markets in Asia. The following is an analysis of those issues that are mainly characteristic of stock markets, those that are characteristic of bond markets, and those that are common to both.

(1) Current Situation and Issues of Stock Markets

1) Market Scale

The scale of the stock market as a percentage of gross domestic product (GDP) is 26.2% in Thailand, 20.0% in Indonesia, 124.9% in Malaysia, 77.6% in the Philippines, and 59.2% in China.[10] In relation to the economies of these countries, their stock markets have shown a certain degree of expansion.

In East Asian markets as well, individuals and other investors who do not take a long-term approach to investment tend to seek short-term capital gains, and there is often an impact from stock prices in Europe, North America, and Japan. Consequently, stock prices fluctuate by even wider margins than in industrialized countries, far removed from business fundamentals. From the standpoint of a company trying to procure funds, these are markets with very unstable capital costs and total funds, and they also show instability as financial intermediary channels. At present, the stock markets are not a stable source of capital for corporate finance, especially for capital investment.

2) Listing Criteria and Review Systems

To list a company, a stock exchange needs to analyze the company to ensure that the company has a proper business management system in place. However, these analyses are lenient, and some companies have been listed in spite of issues in their business management systems. Stock exchanges and agencies that supervise securities trading are making efforts to strengthen corporate governance and compliance at listed companies, but corrective measures are rarely taken with regard to violations.

Since the continual listing requirements are lax, some companies are not delisted even if they have low liquidity, and the issuing bodies pay little attention to ensuring liquidity. In other words, they make little effort to expand the shareholder base.

3) Investors

Stock market investors are primarily individual investors. With the exception of certain countries,[11] institutional investors account for only a small proportion. For example, in Thailand, individual investors account for about 70% of the trading, followed by foreign investors at 20%, while corporate investors (including institutional investors) account for only 10%.

4) Issuing Bodies

Most Asian companies are small to medium enterprises or micro-enterprises. There are few midsize to large corporations in terms of a scale and performance who are eligible for going public. This is also a reason for the scarcity of issuing bodies.

Moreover, many companies that are of a sufficient scale and performance for going public actually do not wish to become listed.[12] If a company can obtain financing at a lower interest rate than that in the market, the company will be less interested in expanding fundraising capacity, which is an advantage of going public. The disadvantages of going public loom larger for these companies, including the requirements of information disclosure and concerns about a possible buyout or takeover.

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[10] For reference, this percentage is 70.9% in Japan's case. The figures are as of the end of 2000. Sources include materials issued by the Council on Customs, Tariffs, Foreign Exchange and Other Transactions (2001), and with regard to China, *Current Situation and Outlook on the Chinese Stock Market* [in Japanese], Fan, Mitsubishi Trust and Banking Corp., Hong Kong Branch.

[11] In Malaysia, public pension funds account for a large share.

[12] Even in advanced countries, some large corporations remain unlisted in order to avoid the requirements of information disclosure.

As a result they remain unlisted. Family businesses in Thailand seem to be examples of companies that choose to remain unlisted after considering the relative advantages and disadvantages of going public.

Most listed companies in China were formerly state-owned companies. There are only a limited number of purely private companies among those listed.

Most foreign-affiliated companies that are active in Asia depend primarily on their parent companies in their home countries to fund capital investment. Very few raise funds by being listed on the stock markets of the Asian countries where they are active.

(2) Current Situation and Issues of Bond Markets

1) Market Scale

Following the Asian crisis, the need was recognized for each country to have a bond market in its own currency, and interest has grown in the establishment of such markets. However, volumes of issuance remain low on corporate bond markets, amounting to 10.2% of GDP in Thailand, 1.7% in Indonesia, 41.3% in Malaysia, [13] and 0.96% in China.[14]

Some of the reasons for the lack of expansion in the bond markets are the lack of bellwether issues of government bonds that could serve as yield benchmarks, the lack of market makers in the secondary market, and the inadequacy of trading and settlement methods.

2) Rating Agencies

There are few bond issuing companies on the market, so rating agencies have few bond issues to rate, and rating institutions remain underdeveloped. In many cases, local rating agencies are affiliated with or receive equity participation from S&P or Moody's. S&P, Moody's, and others are not themselves active in rating local companies.

3) Investors

In bond markets with small investor bases, banks account for a large proportion of bondholders. As long as large proportions of bonds are held by parties that follow the same investment behaviors, it is difficult to ensure liquidity for bonds.

(3) Issues Common to Both Stock Markets and Bond Markets

1) Market Scale and Supervisory Systems

With guidance from the IMF, the World Bank, and other agencies, based on reflection from the lessons of the financial crisis, many Asian countries are now strengthening their organizations to monitor and supervise capital markets, including securities and exchange commissions. However, some markets are seeing insider trading, unfair manipulation of share prices, and spreading of rumors, and the authorities are not monitoring these, so such behavior is not exposed or punished. Consequently there are issues with the soundness and reputation of the markets.

2) Disclosure Systems

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[13] Cagamas bonds (mortgage bonds) and bonds issued by special entities such as Danamodal (a special agency to infuse capital into banks) and Danaharta (an agency to purchase non-performing loans) are also included as corporate bonds. Of all the bonds newly issued in 2000 (excluding Cagamas bonds), 51% were related to corporate restructuring.

[14] For reference, this percentage is 12.9% in Japan's case. The figures are as of the end of 2000. Sources include materials issued by the Council on Customs, Tariffs, Foreign Exchange and Other Transactions (2001), and with regard to China, the 2001 Yearbook of China Financial Statistics.

Investors make investment decisions on the basis of the financial statements and information given by companies. Therefore, publicly held companies are required to disclose their financial statements after having them audited by an audit corporation. They are also required to promptly announce any changes in earnings estimates, business alliances, or other important matters related to business management.

Although governments, agencies that supervise securities trading, and stock exchanges are taking measures to promote disclosure, in fact, information is not being disclosed appropriately in many cases. It is reported that disciplinary measures are hardly ever taken, even when there are problems with disclosure. The lack of proper disclosure reduces the reliability of the markets and increases investment risk.

3) Investors

In the capital markets of advanced countries, institutional investors account for a large share of the trading. However, except for banks, developing countries do not have great numbers of large, diverse institutional investors, such as insurance companies, pension funds, or investment trusts. The holding types of financial assets undergo changes along with economic development, and institutional investors grow during that process. However, Asia has not yet reached the level of diversification in holding types that is found in advanced countries, and there are only small amounts of assets in pension funds, etc. Therefore, in some cases, the proper laws and systems concerning pension funds and investment trusts are not yet thoroughly developed. For example, there may still be legal restrictions on investments in stocks and bonds by pension funds.

4) Underwriters

In order to accept new stocks and bonds and sell them to customers, an underwriter needs to have review capabilities, financial strength, and a customer base. Other requirements include the capability to support capital policymaking and provide advice on the timing of issuance and market trends, but many companies lack a strong underpinning. Since the financial crisis, both local and foreign securities companies have unavoidably had to cut back in scale, and in some countries, including Indonesia, a few foreign securities companies have pulled out altogether. The reason is thought to be that they entered these markets during rapid market expansion but saw trading volume drop in the financial crisis, and then were unable to obtain sufficient profits during the subsequent market recovery.

5) Corporate Auditors

Each country is establishing qualifications and making efforts to obtain more auditors who are capable of auditing the books of listed companies. A large proportion is made up of foreign audit corporations, which have abundant human resources. At present, most of the unresolved issues are on the side of the companies, and market confidence will not be obtained until fundamental changes occur in such business practices as concealing the facts and filing false reports.

6) Rating Agencies and Securities Analysts

It is necessary to establish corporate ratings that are suited to the local situation, after learning the basic methodology from major Western rating agencies. Nothing has been done with regard to improving capabilities for business analysis or establishing methods to rate companies and bonds. This is because of the difficulty of obtaining accurate business information, inadequate financial and accounting systems, and ineffective legislative and judicial systems.

7) Hard Market Infrastructure

There are gaps in the levels of hard infrastructure in the capital markets of Asian countries. However, some progress has been made with advice from Western think tanks specializing in securities.[15] Thailand and Malaysia already have systems that are at the same levels as those of the advanced countries.

8) Financial Products

The means for hedging and financial products in capital markets are not adequately developed, due in part to government restrictions, so the needs of pension funds and investment trusts are not being met.

9) Other Issues for Capital Market Development

The following are some of the other issues for capital market development.[16]

One reason for the lack of vitality in capital markets is that financial markets overall have not yet reached the stage of maturity, so market principles are not yet fully operational. The investment actions taken by investors are to buy bonds when the interest rate is higher than fair value; buy stocks when interest rates are low; borrow money to buy stocks when deposit interest rates are low; and deposit money in banks when deposit interest rates are high. Meanwhile, when loans are available at lower interest rates, companies take out loans instead of procuring funds from the market. However, when the national government guarantees the entire amount of bank deposits, there is no risk on a bank deposit, and this has the effect of restraining investment in capital markets by investors.

There is also a need for fairness in tax systems. For example, there is an obstacle to investment in capital markets when the taxation on interest income from deposits is more favorable than taxation on that from bonds, stock dividend, and capital gains.

In some cases, the financial statements prepared by companies are arbitrary financial data prepared by the business manager, or contain inaccuracies due to the lack of necessary skills on the part of the officers in charge of accounting. Even in such cases, improprieties on the part of the business manager or auditing corporation are rarely punished. There is also an obstacle to investment in capital markets when the law does not protect the personal interest rights and common interest rights of minority stockholders. A precondition for the development of capital markets will be the establishment of this kind of informational, legislative, and judicial infrastructure.[17]

3.3 Assistance

(1) World Bank

1) Basic Stance on Assistance

The World Bank is providing practically no TA for capital market development in Asia, except in Thailand and Malaysia.

2) Assistance Policies for Thailand and Malaysia

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15 Indonesia, which is considered to be further behind in market establishment than Malaysia, is planning to launch a remote transaction system in June of this year to attract distant investors, and it is eager to build an infrastructure for electronic transactions, paperless trading, settlement systems, and so on, taking business models from Malaysia and Singapore.

16 Macroeconomic stability and the development of targeted companies for investment are also necessary for the development of capital markets, but the discussion here is limited to areas related to economic soft infrastructure.

17 More details on corporate accounting and corporate governance are given in the chapters on those subjects.

Since assistance for Thailand is in the form of TA provided as part of the reform of financial institutions, it includes 1) assistance for strategy development and operation of a government bond market, and 2) supervision of securities and insurance companies. In Malaysia, the World Bank has provided survey assistance for the Securities and Exchange Commission concerning trends in the world's capital markets and the role of Malaysia.

(2) Asian Development Bank

1) Basic Stance on Assistance

In Thailand, the ADB is taking a central role in cooperation with the government concerning capital market reorganization and development. It seems to have achieved a certain segregation of roles among other donors including the World Bank. It is also providing some TA in countries other than Thailand.

2) Uncompensated Technical Assistance by the Asian Development Bank

Year and Recipient Country	Program	Amount for Consultation or Execution
1999		
China	Developing the capabilities of the capital market regulatory system	1,000
2000		
Bangladesh	Developing the capabilities of the Securities and Exchange Commission and specific capital market agencies	850
2001		
Pakistan	Capacity building for corporate governance and capital market development	850

Note: Unit: $1,000

(i) Thailand

The ADB adopted a new Country Strategy and Program in August 2001 and is providing policy consultation focused on specific financial institutions, in relation to support for capital markets.

Examples of Assistance in Thailand

Under the Financial Market Reform Program Loan (FMRPL, $300 million), the assistance related to improvement of capital market building is as follows.

Medium to Long-Term Institutional Framework:

(1) Ensuring independence and broader authority for the Securities Commission.

(2) Clarifying the scope of authority of the Ministry of Finance, Central Bank, and Ministry of Commerce, and strengthening regulation and supervision of publicly held companies.

TA to Improve the Effectiveness of Reforms:

(1) Strengthening disclosure and compliance to improve corporate governance.

(2) Securitization of assets for the development of a securities market.

(3) Reform of pension and provident funds for the determination of appropriate options for reforming the current social security program.

(ii) Malaysia
Practically no TA was provided except grants to expand the equity and bond markets in 1999.

(iii) Philippines
In recent years, the ADB has provided support for reorganization of the debt and equity markets, with the goal of promoting broad disclosure, strengthening regulation and supervision, and strengthening management capabilities and professionalism at the Securities Commission and stock exchanges.

(iv) China
The ADB continues to support the strengthening of a regulatory and supervisory framework for capital markets. Specifically, it is providing support for: 1) effective implementation of the securities law enacted in 1999 with support from the ADB, and 2) strengthening of the China Securities Regulatory Commission and promotion of a self responsibility system at the level of stock exchanges and stock market participants.

3.4 Points of Consideration and Future Directions for Assistance[18]

Japan is home to one of the world's three largest financial markets, which are located in New York, Tokyo, and London, and therefore Japan has a predominant role in the area of assistance to capital markets. Japan's securities market has a highly public nature and an outstanding auction market.

For developing countries, it is considered effective to provide cooperation based on the situation and stage of development of the capital market in the country in question. There are three areas of possible cooperation for capital markets. These are system building, management service, and human resource training.

Although the basic framework is already in place for the Asian capital markets, the issue for the future is to improve the level of effectiveness. It is believed that contributions can be made for sound market development by supporting the establishment of specific individual systems; for example, by strengthening the functions of brokers, establishing criteria for listing, preparing rules on disclosure, establishing bond trading and settlement systems, and expanding the investor base (lifting restrictions on investment by institutional investors in capital markets, enacting laws and regulations on investment trusts, and revising purchase units). For example, in the case of listing criteria, more companies will become listed if the listing criteria are relaxed, but there will also be an increase in the number of public

[18] The development of capital markets is considered to be essential for correcting excessive reliance on banks in corporate financing. Infrastructure improvement for capital markets should be tackled as a medium to long-term policy issue, and there are still strong indications that a sound banking system is the most important policy issue that must be addressed now by the developing countries of Asia. The main grounds for this are as follows.
i) Banks play by far the most important role in corporate finance and the importance of strengthening the banking system cannot be ignored in the sustainable economic development of developing countries.
ii) In many Asian countries, banks fulfill an important role in capital markets also, playing the parts of institutional investors in securities, issuers of bank debentures and the like, and underwriters of securities.
iii) Therefore, a sound banking system affects not only the conventional types of banking operations, which are credit creation and settlement functions, but also securities operations. A bank that is involved in the securities business also takes on market risk and risks associated with the acceptance of securities, so it is necessary to consider prudential regulations to deal with these risks.
The approach described above is based on the judgment that it is more realistic for institutional improvement to focus on strengthening the banking system and letting the results of such improvement be reflected in capital markets, considering that the extent of infrastructure building needed to form sound capital markets would require much more time and money than infrastructure building for the banking system, and that the banking system can be functional even though its current infrastructure provides an inadequate environment.

companies that lack proper financial strength and do not maintain sound performance, with the consequence of actually impeding the sound development of capital markets. It is possible to improve the corporate governance of listed companies by means of the listing criteria and delisting criteria, and cooperation can be provided from this perspective.

In terms of administration, it is possible to improve market discipline by providing stock exchanges and agencies that supervise securities trading with guidance on monitoring price manipulation, supervising broker, examining listing, and monitoring disclosure.

In the area of human resource training,[19] there is a need for a wide range of personnel, including not only officers at responsible government agencies but also analysts, canvassers, and even investors (dealers, fund managers, and individual investors). Since the capital market industry in East Asian countries is an industry with a high proportion of industrial organizations such as security business associations, training human resources of private companies through these organizations is an easy and effective approach, owing to their highly public nature.

To arrange these considerations on cooperation into chronological order, support should first be concentrated on the establishment of sound markets, followed by systematic support for market development and activation. In the first stage, considerations include institutional development related to listing and trading, with trading management in the area of administration, and the training of supervisory staff in the area of human resources. In the second stage, considerations include settlement systems, expansion of the investor base, and broker training, with the promotion of investor relations (IR) in the area of administration and the training of investors, analysts, and canvassers in the area of human resources.

[19] In human resource training for the development of capital markets, it is necessary to train attorneys, accountants, and other professionals as well, but the discussion here deals with human resource training that is specific to capital markets in the area of economic soft infrastructure.

Chapter 4: Accounting

4.1 Accounting Situation

Since the latter half of the 1980s, Great Britain and the U.S. have been at the forefront of a movement to promote the internationalization of accounting under the leadership of the International Accounting Standards Committee (IASC).[20] The first major event related to the International Accounting Standards (IAS) was the publication of IAS Exposure Draft 32 (ED 32),[21] "Comparability of Financial Statements," in January 1989. This Exposure Draft is considered to have been the turning point in a shift away from the conventional practice in which multiple accounting methods were recognized, toward the more desirable approach of substantial unification of financial statements.

The second major event was a commitment to IAS by the International Organization of Securities Commissions (IOSCO), whose members include the Securities and Exchange Commission (SEC) of the United States. IOSCO participated in an advisory group to the IASC in 1987 and announced its support for IAS at the 13th assembly at Melbourne in 1988. Later, active involvement by the U.S. Financial Accounting Standards Board (FASB) provided an additional impetus to IAS.

In general, the reason for the flow of international coordination and unification of accounting standards is considered to be this: When businesses in any country procure capital from international financial markets, they prepare financial reports according to accounting standards that differ from country to country, and as a result, analyses by investors and securities analysts are less accurate and meticulous than they could be otherwise. This tends to pose an obstacle to the sound development of financial capital markets in each country.

In Asian nations as well, as the global economy becomes more widespread, the internationalization of accounting has become irreversible, and the introduction of IAS is being pursued under the guidance of international organizations.[22] During this process, considerable disruption and friction has occurred in each country in socioeconomic aspects other than accounting standards as well, and the governments have provided coordination in an attempt to avoid such problems. In any case, the domestic accounting systems of all Asian nations are being changed in relation to IAS, and accounting practices are also in the process of changing in accordance with these revised accounting systems.

In this kind of debate on the internationalization of accounting, there is a tendency to focus only on the accounting of listed companies in capital markets. There has not been much discussion of accounting at small and medium enterprises, although these are the majority in terms of the number of businesses.[23] Most accounting practices at small and

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[20] The International Accounting Standards (IAS) are a set of accounting standards put forward by the International Accounting Standards Committee (IASC), which was founded in June 1973. The founding members were the professional accountants' organizations of nine countries: Australia, Canada, France, Germany, Mexico, the Netherlands, England & Ireland, the U.S., and Japan. (The organization of the IASC changed in 2001; it is now funded by donations from the world's accountants' offices, businesses, and organizations. The fourteen-member International Accounting Standards Board (IASB) plays a central role in determining the standards and so on.)

[21] ED 32 was adopted as a statement of purpose by the IASC Board of Directors in June 1990 after some revisions were made. It was then published in July 1990.

[22] In particular, the internationalization of accounting had an early start in Malaysia, a former British colony, and the Philippines, a former U.S. colony.

[23] In a recent international trend, the United Nations Conference on Trade and Development (UNCTAD) has gradually begun discussions on accounting standards for small and medium enterprises, and there is also discussion on classifying these into the categories of companies that fully apply IAS, companies that apply only the core standards of IAS, and companies that apply the standards of accrual basis accounting along with elements of cash basis accounting. The IASB is considering fifteen types of standards for small and medium enterprises. In Great Britain, Financial Reporting Standards for Small

medium enterprises are either adopted as tax accounting or to fulfill requirements under commercial and accounting laws, and there is a considerable gap compared to accounting at listed companies, which are subject to management and oversight under laws related to capital markets.

4.2 Situation and Issues of Asian Nations

(1) Current Situation of Asian Nations

Although some divergences remain in the accounting standards of Asian nations and international accounting standards, in general there are few regulatory differences from the International Accounting Standards. Few problems are seen even in cases where international accounting standards exist but there are no corresponding domestic standards, as there is a trend toward the gradual introduction of such standards in the future.

Also, there are few problems with the process of standards enactment, although there tend to be fewer statements of opinion in response to the solicitation of views than in Europe and North America. The process begins with the announcement of discussion materials, followed by the solicitation of views from every industry (or the holding of public hearings), publication of a draft, solicitation of views, and publication of the standards.

Current issues are related to the aspect of standard application. Issues have been brought up with regard to preparers of accounting information, auditors, and users of accounting information. The most important issue is the attitude of the preparer of financial statements, or the question of what kind of approach is taken by the business executive, the party with final responsibility for preparation of the financial statements, in preparing financial data. In the Western model of accounting disclosure, the attitude is that the provision of highly transparent, reliable financial data to the information users will have the effect of obtaining their confidence and thereby providing investment opportunities. However, this attitude is not widespread in many Asian nations, where capital markets are still immature. Therefore, many business executives tend to emphasize business secrecy and have a deep-seated resistance toward the disclosure of information.

Meanwhile, in each country, the top-level accountants belong to firms that are affiliated with international accounting offices. Many of them have studied abroad and are considered to be up to international standards. However, questions remain with regard to accountants in general. There are also doubts about whether the accounting staff of businesses, which prepare the financial statements, are up to international standards. Problems range from a lack of basic bookkeeping knowledge to a low level of reliability in the primary financial data. There are also serious problems with inadequate internal control systems, and the need remains for a firm foundation of readiness for external auditing.

(2) Issues

At present in Asian nations, various issues are seen in the area of accounting practices, both in the banking sector and in the capital markets. The following six points are the most pressing issues at present.

1) Lack of manpower: Problems have been pointed out concerning both the quantity and quality of human resources in the area of accounting. It is necessary to train a broad range of human resources, from certified public accountants in a position to

Business (FRSSE) were adopted in 1997 in response to the increasing complexity of British accounting standards. In Canada as well, accounting standards for non-public companies were adopted in 2001.

conduct audits to the accounting staff that handles the practical accounting duties at companies.

2) Inaccuracy of businesses' financial data: In Asia, even large businesses are often family-operated, and they are often unwilling to disclose accurate financial data. When there is no definite distinction between management and ownership, directors tend not to be as firmly committed to the attitude of guaranteeing the accuracy of financial statements as careful managers. There have also been many indications of the manipulation of accounting in group companies, but the main reasons for this seem to be inadequate checking by means of audits[24] and the fact that accountants are not seen as being in a position to provide business guidance.[25] The lack of appropriate business accounting systems has also been pointed out.[26]

Because corporate laws do not provide adequate regulations on companies' financial documents or these regulations are not upheld, in many cases, there is no financial data on a business, particularly in the case of small and medium enterprises. This poses an obstacle to business analysis by analysts and bank officers. The reasons include disregard for the requirement to register reports on final accounts at business registry offices, inadequate activities to promote proper bookkeeping and accounting (certification of bookkeeping, adequate commercial education, etc.), and the lack of widespread adoption of computerized financial accounting systems.

4) Divergence between accounting standards and actual practice: The biggest issue related to accounting standards is that even though the standards are coming closer to international standards (see Reference 1), there is still a wide gap compared to actual accounting practices. To promote actual application, it is necessary to prepare practical accounting guidelines, accounting manuals, etc.

5) IAS for large corporations and accounting at small and medium enterprises: Amid the trend toward globalization, policies for conformity with IAS have been put forward in each Asian nation. However, IAS is basically suited to financial statements that will be used in the multinational procurement of funding, and its standards are generally designed for large corporations. Because IAS is not well suited to small and medium enterprises, debate is taking place on the identification of appropriate accounting standards for small and medium enterprises.

6) Inadequate disclosure: The business information that is being disclosed is inadequate both in quality and in quantity. Other issues remain as well, including the lack of timely disclosure of problematic information.

[24] The businesses legally required to undergo audits in the Asian nations in question are as follows. Thailand: All companies under the corporate income tax law. Malaysia: All companies. Philippines: Listed companies and companies of at least a certain size (revenues and total assets) under the corporate income tax law. Indonesia: Publicly held companies, banks, insurance companies, leasing companies, securities companies, foreign investment companies, and companies having at least a certain amount in total assets. China: All joint-stock companies and foreign investment companies.

[25] Audit memoranda need to be submitted appropriately and in a timely manner.

[26] Establishing legally mandated reserves for currency risk in foreign currency denominated credits and obligations, revising the assessment of credit retention and excess inventory, etc.

Reference 1: General Conditions of Accounting Standards in the Asian Countries in Question

Country	Accounting Standards
Malaysia	The Malaysian Accounting Standards Board (MASB) of the Ministry of Finance, established under the Financial Reporting Act of 1997, determines the standards; but these basically follow the International Accounting Standards.
Philippines	Accounting standards are determined by the Accounting Standards Council of the Board of Accountancy, but these are generally taken directly from U.S. accounting standards.
Indonesia	Accounting standards are determined by a committee on financial accounting standards. Since 1994, the accountants' association has applied accounting standards that are basically a translation of the International Accounting Standards.
Thailand	The accountants' association determines accounting standards that are similar to the International Accounting Standards. Audited financial statements are required to be registered with the commercial registration bureau (corporate income tax law).
China	Accounting standards are established independently. Under the Accounting Act (enacted in 1985, revised in 1993), the Division of Administration of Accounting Affairs (DAAA) of the Ministry of Finance has jurisdiction over the establishment of standards. In 1993, this division issued a set of accounting standards for business enterprises (ASBE), determining a general framework for accounting standards. In 1998, an accounting standards committee was established within DAAA, and under the supervision of the Ministry of Finance, it has been involved in improving the accounting standards. In late 2001, the government enforced the revised Accounting Act for coordination with IAS.

Source: Prepared by the authors, based on *Business Accounting* by Masakazu Takahashi, March 2001 (Japan International Cooperation Agency, Business Strategy Survey Research, Basic Research on Cooperation through Financial Policy Support), IASB web site, IMF Report on the Observance of Standards and Codes, and other sources.

4.3 Assistance

In recent years, both the content of accounting standards and the activities of organizations that determine accounting standards have been undergoing a process of international unification. That is, there has been a rapid shift from acquisition cost based accounting to fair value accounting. Accounting is becoming increasingly internationalized in Asia as well. In other words, domestic accounting systems in each Asian country are being revised with reference to International Accounting Standards, and accounting practices at individual companies are also in the midst of a process of change.[27]

Corporate accounting is an interrelated part of business practices, systems, and theories, and it is positioned within the framework of social controls on joint-stock companies and stock markets. Therefore, the introduction of the International Accounting Standards has not only caused problems related to the content of accounting standards such as fair-value accounting, but also has led to socioeconomic disruption and friction in many areas, including organizations that establish accounting standards and the processes of establishing standards, the roles and directions of disclosure systems, fundraising methods, and capital markets. Therefore, the governments of Asian nations have been making efforts to avoid friction through political compromise while striving to achieve a balance between maintaining the unique characteristics of their individual country and conforming to the International Accounting Standards.

Under these circumstances, international organizations such as the World Bank and the IMF have provided technical support for Asian nations in the form of assistance in the improvement of accounting audit systems. For example, in China, support has been provided

[27] The process by which the accounting practices and accounting systems of advanced countries are being transplanted to Asian nations by means of the International Accounting Standards is completely opposite from the original process by which these accounting practices and accounting systems were formed in advanced countries. This is a special characteristic of the situation of developing nations in Asia.

by the World Bank since 1992 for the establishment of basic rules for business accounting, to deal with China's transition toward a market economy.

Meanwhile, the International Federation of Accountants (IFAC) is providing support to Asian nations in the preparation of audit standards, ethical rules, and other standards, along with the World Bank and the IMF. Also, the European Federation of Accountants (FEE) is providing support for the introduction of IAS in Vietnam. In Japan as well, since the 1980s audit corporations have accepted trainees from China's State Council, Ministry of Finance.

4.4 Points of Consideration and Directions for Assistance

(1) Points to Consider in Studying the Content of Assistance

With regard to assistance for Asian nations in the area of accounting, there is recognition of the urgency of building the necessary basic infrastructure for sound development of financial markets. There is a wide range of needs in areas such as training human resources in financial statement preparation and auditing, preparing practical accounting guidelines, and studying accounting systems for small and medium enterprises. The following points must be kept in mind in future study on directions for Japanese support.

1) Emphasize the approach of using Japanese experience to provide assistance. Specifically, this could include the provision of expertise or incentives linked to taxation, such as the tax accountant system or blue form income tax return system, to support accounting at small and medium enterprises in particular.
2) The most important issue for accounting in Asia is the divergence between accounting standards and accounting practices. Assistance for improvement of this issue could make use of Japan's experience gained through the process of changing accounting practices and preparing guidelines, etc. at the stage of IAS application.
3) Support should be centered on the training of a broad range of human resources through such means as the exchange of personnel with Asian nations.
4) It is important to confirm the actual needs by means of thorough discussion with the countries in question.

(2) Directions for Future Assistance

It is desirable to provide comprehensive support measures in the area of accounting, based on the above considerations and including the training of a broad range of human resources. Assistance that would be particularly effective for the Asian nations in question includes practical measures such as support to improve the capabilities of accounting staff at businesses, support for accounting at small and medium enterprises, and support for the preparation of accounting guidelines and auditing guidelines to allow a smooth transition of accounting practices in conjunction with changes in accounting systems based on the International Accounting Standards (IAS). (See Reference 2.)

Reference 2: Specific Examples of Assistance

Type of Assistance	Content, Purpose, etc.
(1) Assistance for the preparation of accounting guidelines and auditing guidelines	In the processes, decision-making organizations, and methods used to establish accounting standards, due process is basically followed in each Asian country, including the publication of materials followed by the solicitation of comments and the publication of standards. Therefore, rather than providing support for the actual determination of standards, support could be provided for problems at the application stage of the standards, such as the preparation of accounting guidelines and auditing guidelines and the education of practitioners. At some audit corporations, support is already being provided for the preparation of guidelines and other practical guidance in accounting for the countries where they are active. Assistance in this area is important, considering the problem of divergence between standards and actual practice in Asia. The Accounting Standards Board of Japan (ASBJ) is preparing standards for application, making use of Japan's own experience in adapting the International Accounting Standards to suit Japanese culture, and there are possibilities for support in this area.
(2) Assistance for the establishment of bookkeeping certification programs	Improving the capabilities of officers who handle the bookkeeping at businesses is an important issue. Therefore, it is necessary to establish bookkeeping certification programs to promote the spread of proper bookkeeping practices. Introduction of programs based on the International Accounting Standards, such as English language bookkeeping certifications, could be quite effective in improving the capabilities of bookkeepers.
(3) Incentives for the preparation of financial statements	In indirect financing, the lack of reliable financial statements at small- and medium-size enterprises is a problem. In Japan, the blue form income tax return system has continued since its introduction as a postwar measure to ensure tax revenues, and support could be provided for the introduction of similar programs as a way to resolve this problem. Although Japan has no system to audit the accounting of small- and medium-size enterprises, these companies do prepare financial statements which function effectively with a certain level of reliability in financing for small- and medium-size enterprises, and this is considered to be a result of the blue form income tax return system. Through the introduction of this system, it would be possible to improve incentives for the preparation of financial statements by small- and medium-size enterprises.
(4) Assistance for joint research on accounting	In each country, the specialists in accounting are accountants and participants in the establishment of accounting standards as well as university professors in many cases. This means that it is especially significant to support research in the study of accounting in Asian nations through joint research programs, etc. Although this kind of "soft" support is less visible than "hard" support, it is an effective mode of support, including its appeal to other countries. At the same time, it would also be effective to hold meetings such as Asian accounting conferences in Japan, or promote comparative research on each country and publish the results in English. Another method would be to promote desirable accounting education by providing sponsored professorships and sponsored lectureships at educational institutions (universities).
(5) Assistance for accounting at small- and medium-size enterprises (problems of accounting standards and problems of application, including auditing)	The issue of what accounting standards to apply in small and medium enterprises is a problem not only of Asian countries but also of the entire world. The International Accounting Standards require advanced accounting procedures, and it would be difficult to apply them completely in small- and medium-size enterprises. The International Accounting Standards are aimed at investors, and it is not necessarily appropriate to apply them at small- and medium-size enterprises, where many users will have limited uses or non-investment purposes. Related issues are being discussed by UNCTAD, ASEAN accountants' associations, and in Japan (for example, at the council on small- and medium-size enterprise accounting, administered by the Small- and Medium-size Enterprise Agency). The results of such a study could be shared among East Asian nations to support the formulation of realistic accounting standards for small- and medium-size enterprises. However, it is possible that realization could be difficult because of problems in the coexistence of two different sets of standards, distinguishing between large businesses and small- and medium-size enterprises, and continuity in the case that a small- or medium-size enterprise becomes a large business. Therefore, rather than simply providing guidance for the formulation of new standards for small- and medium-size enterprises, support should take the form of studying the extent of feasible application, considering the level and importance of small- and medium-size enterprises within the framework of each country's accounting standards.
(6) Assistance for the establishment of programs to evaluate and recognize disclosure	In Asia, even the executives of listed companies are often reluctant to disclose financial information. One way to correct this would be to introduce programs to evaluate and recognize disclosure. A program of this kind has already been introduced in the Malaysian stock market. In the Malaysian program, recognition has the effect of lowering fundraising costs. Support for the introduction of similar programs in other countries could be expected to change the passive attitude of business executives toward information disclosure.

Chapter 5: Corporate Governance

5.1 Situation of Corporate Governance

In advanced countries, debate on corporate governance[28] (CG) rapidly intensified around the 1990s as industrial reorganization heated up across borders amid the globalization of finance and capital. Gaps exist among the CG structures of companies in each country, even among advanced nations. For example, CG in the U.S. and England emphasizes shareholders' equity, while CG in continental Europe still has some elements that emphasize corporate equity. The process of globalization provided a major impetus for focusing attention on these differences.

Businesses in advanced countries have a long history of development. Differences in CG structures are based on differences in the organizational structures of businesses, according to the Anglo-American and continental European legal structures, and these reflect various aspects of each country's background, including the development of capital markets, the scale of domestic markets, the speed of internationalization, business organizations, and business cultures. However, now that the movement of capital has reached an unprecedented speed and scale, the Organization for Economic Cooperation and Development (OECD) has begun finding possibilities for institutional convergence of best practices in CG principles, especially concerning the logic of capital, while recognizing differences.[29]

Meanwhile, unlike the debate in advanced countries, CG reforms have intensified sharply in emerging countries since the currency and financial crisis, especially in East Asia; and there has been pressure to achieve these reforms by setting up reform programs in a short period of time, with little time for debate or trial and error. The Washington Consensus implied that the crisis of liquidity in each country's market was caused by inappropriate CG structures at East Asian businesses, which caused the loss of investor confidence. With the strong U.S. economy as a contributing factor, the Washington Consensus was highly influential in formulating the IMF program. Since CG was considered to be the origin of the currency and financial crisis, CG reforms in East Asia were mainly debated from the standpoint of investor protection, based on a scenario that included shifting business financing from a model centered on bank loans to one centered on the bond and stock markets, strengthening market discipline, improvements in CG, and improvements in market confidence. However, developing countries are dependent on indirect financing and primarily bank loans, unlike the economic structures of advanced nations in Europe and North America, where the development of stock markets and other direct finance markets has been strong, requiring robust investor protections. Considering this difference, it is also important to protect creditors along with investors, but this point has been given little emphasis. There have been no great differences in the framework of reforms in countries that did not directly undergo the crisis, including Taiwan and China, compared to the markets where the crisis occurred. However, moving from the stage of establishing reform

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[28] The term "corporate governance" is used in the narrow sense to indicate the question of who owns a company, or the relationship between a company and its shareholders, especially the question of how a company passes along profits to shareholders. In the broad sense, this term is considered to include the three concepts of [1] the administrative decision making mechanism of a company, [2] the mechanism for coordinating relationships among the parties whose interests are closely tied to the company's performance, and [3] the methods by which shareholders can monitor or control the company's management (based on *An International Comparison of Corporate Governance Structures* [in Japanese], Mitsuhiro Fukao and Yasuko Morita, March 1993, p. 9).

[29] The OECD adopted guidelines at a 1999 ministerial summit. These guidelines summarize the core elements of outstanding corporate governance structures with regard to shareholder rights, shareholder equality (including the protection of minority shareholders), the role of stakeholders, information disclosure, and transparency. The guidelines are used as a benchmark by national governments in evaluating their respective laws and regulations.

programs into the process of trial and error in actual application, it is becoming clear that these programs, set up hastily after the crisis, do have various limitations.

5.2 Situation and Issues of Asian Nations

(1) Situation in Asian Nations

As economic strength continued prior to the Asian currency crisis, family businesses engaged in business expansion and formed conglomerates, conducting more fundraising from external sources, primarily bank loans. Along with these environmental changes, some issues became evident, including the asymmetry[30] of information between family businesses and external financial institutions and investors.

Meanwhile, banks in groups of family businesses have conventionally functioned as keepers of the group's safe, so they have provided large amounts of financing without sufficient risk analysis. In other words, banks have failed to fulfill their proper role in improving corporate governance. For example, they have not been in a position to manage and supervise the business activities of their borrowers.

Under these circumstances, debate has intensified on reforming governance in East Asia since the currency and financial crisis, and efforts have been made for institutional development through reform programs set up by the IMF and the World Bank and influenced by the Washington Consensus. However, various limitations have come to the surface as these programs enter the stage of practical implementation.

(2) Issues: Limitations in Emerging Markets

Businesses have their own circumstances as the players in emerging markets, and there are several issues that cannot necessarily be overcome by merely copying Anglo-American governance structures, which are premised on the public listing of companies and the separation of ownership and management. The following are some points for consideration in the application of these structures.

1) Paradox of market development and incentives against public listing:

Anglo-American market discipline is based on the tacit understanding that businesses will naturally go public in the course of their development. However, going public is not necessarily attractive to many businesses in East Asia. For example, in times when economic growth was strong and the price of real estate continued to rise, businesses were able to easily obtain bank loans secured by real estate, even if their business performance experienced some degree of fluctuation. This pattern has not disappeared, considering latent growth potential, even if some adjustment has occurred since the collapse of the economic bubble. And in the case of owner management, where ownership and management are not separated, there are concerns that the disclosure requirements of public listing would lead to heavier tax burdens, or that purchase pressures would come along with public listing. Meanwhile, if the standards and reviews for listing are made lax in consideration of these circumstances, or listed companies are not properly monitored, the result may be that information disclosure is insufficient, and window-dressing in accounting practices may cause market disruption, again going against the principle of improving transparency.

[30] Family businesses generally take a passive attitude toward the disclosure of information on business activities to creditors, outside shareholders, and so on. It is believed that the resulting lack of transparency in business activities has led to a lack of trust in the banking sector, posing an obstacle to the development of sound financial markets.

2) Existence of internal trading:

In emerging markets that are becoming generally accessible to foreign capital, the extreme market segmentation seen in economies at a lower stage of development is disappearing. However, in periods of rapid growth, it is undeniably easier to adapt to rapid change by internalizing the markets of diverse business areas. In many cases, business groups are formed and the scale of internal trading is expanded.[31] In particular, in the case of today's emerging companies that are expanding along with globalization, the scale of internal trade within a group is much larger and more complex than in the past. For example, this can include financial transactions not only with banks but also with non-banks related to the manufacturing industry or other financial institutions that are not easily regulated; and it is not unusual for internal trading to include foreign business operations on a relatively large scale. Although the introduction of International Accounting Standards is being advocated in many countries, the consolidation standards for large corporate groups still differ from country to country, and these may include vague areas, allowing companies to continue using procedures that do not accurately reflect reality. For the near future, it is expected that information disclosure only on the level of individual publicly held companies and bond issuing companies will not be sufficient to build a proper environment for protecting the interests of investors.

3) Lack of major principal-agent problems,[32] and the opposition of large shareholders vs. employees:

For family businesses, which do not have separation of ownership and management and therefore have not had significant principal-agent problems, the CG reforms based on market disciplines, as led by the IMF and World Bank, have focused on strengthening management supervision through the introduction of external directors and protecting minority shareholders. However, when the ownership shares of the founding families are added to the shares of stock held mutually by group companies, the proportion of internal shareholding is extremely high in many East Asian business groups; and even among publicly held businesses, minority shareholders account for very small shares. It is not easy to produce minority shareholder monitoring incentives, except in cases where there are civic movements. Meanwhile, as structural reforms have become more serious, opposition has emerged between large shareholders and internal interests such as those of employees. The reforms have not given much attention to mechanisms for the harmonization of such opposition, and the issue of flexibility in the labor market remains a barrier to the realization of shareholder-centered CG. It is necessary to include social perspectives in considering whether it is appropriate to introduce American-style GC.

4) Coordination with stakeholders other than investors:

The East Asian crisis had major elements of a confidence crisis with regard to investors and lenders, and the CG reforms led by the IMF and World Bank have concentrated only on aspects of finance. However, in the case of very large businesses, especially in the manufacturing industry that has played a major role as the economic foundation of East Asia, there are many stakeholders including customers, business partners (subcontractors), and community residents in addition to employees. Without coordinating their interests, there are limits to what can be accomplished by bold business shifts and structural

[31] In the stage of rapid economic growth, Asian businesses achieved business diversification among their group companies by absorbing businesses from a wide range of areas into a group. This has allowed them to respond flexibly to changes in the industrial environment and to enjoy the stability of internal trading.

[32] In family businesses, there is not much of a principal-agent problem because in many cases, there is no separation between the shareholders, or principals who provide capital, and the business executives, or agents who operate that capital.

changes. There are already some issues of contention, including environmental issues; and with regard to CG, it is necessary to give consideration to a wide range of interested parties and to consider the social roles of businesses, instead of merely concentrating on activities for investor relations.

5) Lack of professional executives:
In many countries, systems for external directors have been introduced; however, doubts about their effectiveness began to arise early on. In addition to the former complaint about their inexperience as professional business executives, external directors are often chosen because of special relationships such as college cliques, so they cannot easily function as objective external monitors; and since their very appointment is a strong reflection of the wishes of the owners and executives, external directors tend to be people who act as yes-men. When bureaucrats parachute into these positions from supervisory government agencies or related banks, this can again result in relationships that lack transparency. So for the time being, there is no choice but to accept this lack of human resources.

5.3 Assistance

Since the currency crisis, the World Bank and other organizations have stressed technical assistance for corporate governance in their overall strategies, with the goal of continuous economic development. In East Asia in particular, the basic strategy is the application of global experience in each country.

As indicated in the World Bank's country assistance strategies (CAS) and so on, the World Bank is focusing on loans with conditions attached to improve governance in the comprehensive sense, including CG and measures against corruption. This type of support is being provided in close cooperation with the IMF and the ADB.

Meanwhile, the World Bank is providing technical assistance in Thailand for business reform. Specifically, this technical assistance covers areas such as improving organizational frameworks for regulation and establishment of standards on accounting and auditing,[33] improving the quality of financial information from publicly managed companies, strengthening the functions of directors at listed companies and financial institutions, protecting minority shareholders, and strengthening the internal audits of listed companies and oversight functions at financial institutions. (See the table below.)

Content of project	Amount (2001 budget) Unit: $U.S.	Source of funding
Improving accounting and auditing standards and practices, and strengthening the functions of the Thailand Certified Public Accountants Association	343,000	World Bank
Establishing the Thailand Financial Accounting Standard Board and improving accounting standards	100,000	USAID
Advisory assistance for regulation of supervision concerning accounting and disclosure at financial institutions	95,000	USAID
Enhancing the authority of directors	320,000	EU
Assistance from the Asia Fund for the National Commission of Counter Corruption	500,000	USAID
Support for improving corporate governance of financial institutions	500,000	USAID

Source: Taken from *Country Development, Partnership for Competitiveness* (June 13, 2001), World Bank.

[33] This includes establishment of the Thailand Financial Accounting Standard Board, strengthening the organization of the Thailand Certified Public Accountants Association, and improving the effectiveness of punitive procedures for CPAs who violate ethical rules.

5.4 Points of Consideration and Directions for Assistance

(1) Points to Consider and Future Directions for Assistance

1) Indicating a comprehensive approach:
The issues in East Asia have shifted from containing the currency and financial crisis to achieving structural reform and laying the foundation for continuous growth. Investor confidence can ultimately be regained by cooperating in building peripheral infrastructures, considering the building of comprehensive mechanisms for the coordination of interests, and monitoring business executives, while looking back on the formation process of CG structures in Japan.

2) Initiatives for institutional convergence:
There are differences in the extent and types of internal trading and financing by business groups, but this structure is found all over East Asia. Japan also developed with a unique structure of industrial conglomerates. From the long-term perspective, institutional convergence can be obtained in the region by maintaining the stability afforded by internal trading, while also devising regulations for more transparent in-house financing and other systems to ensure transparency and risk dispersion. This would be advantageous for Japanese investors as well.

3) Strengthening concurrent monitoring functions from both the market side and the bank lending side:
Businesses that belong to conglomerates in Asian nations tend to raise funds through the means that offer the most advantageous terms and the least stringent requirements for disclosure. In other words, they enter the market if it seems that this will be an easy way to procure funds; but if the market has disclosure requirements that are too strict, they shift to bank financing. Therefore, to promote direct financing in the market, it is necessary to take institutional steps to strengthen monitoring from the side of indirect financing.

4) Improving transparency through computerization:
At present, the IT revolution is progressing rapidly in East Asia, and major changes are occurring in corporate accounting and in settlement systems with financial institutions. If strong security systems are built to prevent falsification and data leaks, computerization with the latecomer's advantage has the potential to make important contributions in East Asia, such as improving the transparency of corporate accounting and streamlining tax affairs. It was because of globalization that East Asia experienced rapid development and also fell rapidly into a financial crisis; and it is meaningful to consider a leapfrog type of approach to CG improvement, making use of information technology.

(2) Specific Content of Assistance

Support related to CG consists of developing an environment to encourage corporate information disclosure and improving internal controls and external monitoring. It is effective to hold seminars and the like based on the kind of approach described below, and to provide support on individual issues.

The introduction of recognition systems could be considered as a way to encourage businesses to improve CG. Another effective means could be to hold educational activities on the various advantages that can be gained by introducing CG to ensure reliability.

With regard to external monitoring, possible means of support include systems for internal financial monitoring by banks, financial supervisory operation in universal banking services, and advice on the preparation of consolidated financial statements. Another possibility would be to train institutional investors for the sake of monitoring by institutional investors.

To improve internal monitoring, some options are improving legislation, including the introduction of internal audits, auditors and external directors, the establishment and development of market oversight functions, and cooperation in training executive personnel.

Chapter 6: Financial Legislative Infrastructure

6.1 Relevant Scope of Financial Legislative Infrastructure

In a discussion of the financial legislative infrastructure, it is first necessary to clearly define what is meant by financial legislative infrastructure. In the narrow sense, the financial legislative infrastructure consists of those laws that directly regulate all finance mediating institutions that exist in a country (including the central bank law, banking law, credit association law, and securities and exchange law); while in the broad sense, the financial legislative infrastructure includes these as well as all other laws generally related to financial transactions (such as corporate law, contract law, bankruptcy law, economic laws, and other peripheral laws).

Since the purpose of this paper is to discuss the financial legislative infrastructure that is desirable in Asian countries in light of the financial crisis, now that general weakness has been recognized in the overall legislative infrastructure related to market economics that is the core of the economic soft infrastructure in these countries, this paper will provide an overview of financial legislative infrastructure in the broad sense.

Central banks, commercial banks, and other financial institutions function as the heart and blood vessels that supply an unimpeded flow of currency, the lifeblood of economic activities, to each economic unit. Certain laws and functions are needed to regulate this flow of currency, and these constitute the financial legislative infrastructure and market order.

6.2 Conditions and Issues in East Asia

To understand the financial legislative infrastructure in East Asian capitalist countries and transitional countries toward market economy, it is essential to take a historical view of the course of economic development in each country. In particular, the economic systems and legislative systems related to market economics that were established by the colonial powers before independence formed the basic legal structure, with the exception of some countries that lost this continuity of institutional development through a transition to socialism. These have had an important influence on legal culture and legal interpretation.

For example, Thailand is a country that emphasizes the statutory legal system culminating with constitutional law, since it was never colonized. However, its laws, which are closely related to economic activities, draw heavily on French and British law, and its financial laws show a great deal of Anglo-American influence. Indonesia, a former Dutch colony, has a continental legal system as does the Netherlands, and it also emphasizes the statutory legal system. Therefore, its laws and judicial structure are also founded on the Dutch legal system. However, its financial laws are heavily influenced by Anglo-American law, which has developed on the basis of judicial precedent, and there is variance in some cases from a positive law system. In the Philippines, influenced by its period of American occupation, the legal system closely resembles that of the United States. In Malaysia, there is a stronger British influence. China is a country that emphasizes the statutory legal system, but in its transition toward a market economy, it is in the process of enacting various laws that draw on the legal systems of many countries including Japan. Still, its system of financial law shows a great deal of Anglo-American influence.

In East Asia, state-led economic development has been the norm subsequent to independence, and in many countries, government intervention has had a significant influence in the administration of economic policy, along with market mechanisms. At the same time, international organizations have exerted a strong influence on economic development, and in countries that have introduced and enforced global standards in their legal systems as part of the conditions on economic structural adjustments or under the GATT-WTO system, which promotes global trade liberalization, a divergence has occurred between the legal systems and economic reality. There is a tendency for administrative discretion to become expanded in order to make up for this gap. There are also inadequacies in terms of enforcing legislation (obtaining sufficient manpower, establishing operational standards, etc.), and in some cases, the legislation established to provide transparency and predictability in trade has become dysfunctional.

Because financial legal systems have the economic role of establishing order and safety in trade, guaranteeing smooth financial mediation functions, and controlling and correcting market excesses, they include compulsory legal regulations with many governmental controls, unlike economic activities in which the principles of private autonomy and freedom of contract are generally accepted. For example, licenses and permits are required to run a financial institution, unlike a general enterprise, and a great deal of administrative supervision and guidelines are established by law and administrative discretion, including capital regulations, safety standards, assessments, and inspections.

Therefore, in evaluating the performance of financial legislative infrastructure, it is necessary to pay attention to the human resources, capabilities, and organizations of the administrative agencies that are responsible for ensuring the smooth enforcement of laws, instead of merely focusing on the appropriateness of the relevant policies and statutory laws.

As stated above, the financial crisis in East Asia took place amid a very large gap between real economic development and the institutions that should support that development, including laws related to financial activities.

In addition to flaws in the financial legislative infrastructure itself, there was a lack of awareness of the weak underpinnings of the economic entities and business entities that were borrowing funds from financial institutions. Before the Asian crisis, financial institutions paid little attention to the analysis of information on borrower companies; instead they emphasized collateral, especially real estate security, and as the value of the real estate provided as security rose, they expanded lending to borrowers. When the crisis occurred, these loans abruptly became uncollectible. Decisions on the economic viability of a borrowing company should be based on objective corporate information and business analyses. However, in addition to the lack of availability of accurate corporate information, financial institutions did not make adequate efforts to address this area.

As stated in the preceding chapter, the disclosure of information to shareholders and creditors is important for the sound development of markets and financial infrastructure. Here, the following points can be noted with regard to legal systems.

Registration-based public notification systems provide for the reporting of various types of information, including business names and addresses, capital, stock, convertible bonds, subscription rights, executives, floating charges, and assignment of obligations. However, the accuracy of this information is, of course, a precondition. In Indonesia, for example, the law provides for a registration system, but the public notification that fulfills its purpose is said to have poor reliability. Securities and exchange laws also regulate disclosure, but a more comprehensive and systematic legal environment is needed with regard to orderly markets to ensure the disclosure of objective information. For example, it is also necessary to promote the disclosure of objective information by providing mechanisms under corporate law for business monitoring and the clarification of obligations with regard to creditors, and mechanisms under bankruptcy law to pursue the responsibility of executives and controlling shareholders.

Another characteristic failing of the market economies in these developing countries is the presence of unresolved basic and fundamental issues in their legislative systems, including the insufficient capabilities of courts as the agencies to enforce bankruptcy laws, inadequate security laws, improper auction procedures, and a lack of objectivity in realty rights.

6.3 Assistance: Issues in Conventional Legislative Assistance by International Organizations

One issue in conventional support for legislative improvement by international organizations has been that these organizations have established deadlines for the required enactment of laws in specific areas. Deadlines for the establishment of legislation in specific fields have been set as a condition for adjustment of the domestic economic structure, and as a result, laws have been enacted and enforced without an adequate policy debate. This has been especially marked in the area of economic activities.

Since laws have been framed within a limited period of time in the case of support from international organizations for legislative improvement, there has been no choice but to ignore the related needs of the local economy and society to some extent. In developing countries, new laws have been introduced in a government-led manner in many cases because of international pressures or a reluctance to fall behind global economic trends. Normally when new economic laws are enacted, these laws are thoroughly debated from various perspectives by interested parties in the affected industries and the administration, judiciary, etc., until a certain consensus is reached. When this has happened, it is easier to build an institutional framework for the enforcement, operation, and application of the new law, and it is more likely that the interested parties will abide by the law. In developing countries, there is not a great deal of debate or deliberation in this area, so after such a law is enacted, there is a tendency for misinterpretation or for government actions that lack transparency in the actual operation and application of the law, due to insufficient comprehension of the law's purpose. From the standpoint of businesses, individuals, and others whose interests in economic activities and their results will be directly affected, there is deep mistrust and dissatisfaction concerning laws that are enacted and applied without sufficient debate, so naturally they do not feel much incentive to abide by these laws. Designing legislation in the area of finance means the framing of laws to prescribe the allocation of resources.[34] In so doing, it is necessary to determine the relationships of rights and responsibilities from the standpoint of allocating scarce resources, and the principle of fairness must be applied in operation, especially because there are few opportunities for the courts to examine financial legislation that is highly technical and policy oriented. The interested parties differ according to the stage of economic development, but it is not desirable to design legislation without thoroughly considering these aspects in East Asia, especially in the area of finance.

In formulating legislation, there is a tendency to neglect the issue of establishing agencies to enforce the laws and ensuring that they have the proper capacity, but this is an area of the greatest importance. Unless the parties who will enforce the laws have a clear and complete understanding of the purpose of the legislation, it will be nothing more than "pie in the sky," and the policies cannot be realized through enforcement. Therefore, it is necessary to educate the parties who will enforce the laws, construct appropriate systems at the enforcement agencies, and design institutions for wide-ranging educational activities aimed at those to whom the laws will apply in general.

Of course, each of the countries in question has its own culture, values, and business practices, and these elements must be reflected by the parties in charge of applying the laws and by the systems for arbitration and legal action in case of disputes. Rather than seeking a

[34] Norio Hirai, *Legal Policy Studies: Theories and Techniques of Legislative Design* [in Japanese], Second Edition, Yuhikaku, 1995, p. 7.

single uniform model, it is necessary to design legislative systems that suit the situations of each country, based on studies of comparative legislation and legislative history and considering the peculiarity of each country.

6.4 Points of Consideration and Directions for Assistance

(1) Basic Approach in Legislative Assistance

The basic approach in legislative support must be premised on an accurate understanding of the realities in the country in question. Support in the field of legislation by international organizations in the past has concentrated on enacting statutory laws that are modeled after advanced countries with mature markets and democracies, and there has been little attention given to the socioeconomic situations lying behind the legislation. There has also been insufficient follow-up in building institutions and training human resources for enactment based on an awareness of statutory law.

Therefore, the approach to legislative support in the area of finance should use the following procedures as a basic course of action.

1) Conduct wide-ranging social surveys on the relevant field in the country in question (including the stage of economic development, government policies, and attitudes toward law-abiding behavior).
2) Analyze the degree of divergence from the reality determined through step 1) by surveying existing laws and judicial precedents.
3) Provide advice on the need to formulate appropriate legal policies, revise existing legislation, or enact new laws.
4) Train human resources and provide concrete support to establish enactment agencies.

The above approach should be subdivided into detailed items, and thorough execution plans should be prepared for each phase. Unlike the case of general ODA support projects, the effectiveness of the results obtained through support for legislative improvement is discovered in the course of social development, so it needs to be long lasting and continuous. The ultimate goal of support for legislative improvement is to promote the development and transformation of local society, and this kind of approach is particularly important in the area of financial law as well when one realizes the magnitude of its economic impact. In some cases, from necessity in the course of economic development, there is no choice but to enact legislation while knowing that there are some institutional flaws; however, it is important to take the time for continued efforts to achieve coordination between these laws and the real economy and society, in addition to the legal coherence of the laws.

In support for legislative improvement, it is important to keep in mind the cross-border effects of economic globalization and liberalization in recent years, and to accurately reflect the impact on domestic legislative systems of international commitments (such as the Basel Accord, horizontal and individual commitments on liberalization under GATS Mode 3 of the WTO, ASEAN financial cooperation, etc.) and the international financial stance on the countries in question.

(2) Future Directions of Japan's Assistance

In future directions for Japan's support in the area of financial legislation, it is desirable to basically follow the approach described in part 6.4 (1). In the area of financial legislation as well, based on the impact of assistance in the case of a limited scope, it is necessary to focus on the fields that will offer the greatest ripple effects.

Also, to make full use of Japan's experience, it is important to consider the correlation with Japan's legal policies, legislation, and administrative agencies in the same area, and to discover which portions should be emulated and which portions should be considered as instructive mistakes. A clear explanation of the cause-effect relationships behind the successes and failures of Japan's financial policies and administration will be more understandable for the recipients of support.

Rather than having a team from the Japan side unilaterally working on support in the area of financial legislation, it is desirable to establish a task force that includes academics, experts, administrative officials, and policy makers from the recipient country, and to pursue support in the form of joint research. In the ASEAN nations, it is expected that closer regional cooperation will develop in the future, so consideration could be given to the possibility of holding joint seminars to include all countries of the region.

Concerning the specific areas of study, it is necessary to analyze the actual issues in each country and conduct research on designing institutions to contribute to the resolution of those issues. This study should take a systematic view of laws that directly regulate finance mediating institutions, including the central bank law, banking law, and credit association law; laws that are related to financial trade in general, including the securities and exchange law, interest rate restriction law, and laws on bills of exchange and checks; and laws that more generally regulate an orderly market, such as corporate law, contract law, bankruptcy law, and economic laws. The following are some matters for study and research in each of these respective areas of financial legislation; however, it is necessary to consider them from a comprehensive standpoint.

1) Legal areas related to financial institutions and financial transactions
   - Central bank law, banking law, and other laws related to financial institutions: Analyze the laws regulating financial institutions, and research their consistency with government policy, the soundness of financial institutions, and the suitability of corporate governance structures.
   - Securities and exchange law, interest rate restriction law, laws on bills of exchange and checks, warranty law, and other laws related to financial transactions: In the area of laws regulating transactions in financial markets, research the extent of government intervention, ethical values in trade, contractual concepts, and other aspects of market autonomy.

2) Legal areas related to orderly markets in general
   - Corporate law, corporate registration law, contract law, accounting law, etc.: Analyze the basic regulations established to improve the efficiency of market functions, and clarify the state of these regulations, and on that basis, determine the correlation in terms of their direct impact on the area of finance.
   - Bankruptcy law and other economic laws: Since this area of law covers the improvement of market efficiency, conduct research on the enforcement agencies, implementing agencies, and executive agencies with regard to their organizational systems, human resources, and efficiency.