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Financial reforms for East Asian cooperation: focusing on the cases in Japan and China

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Abstract

Consolidation of the bond markets for individual countries in East Asia is a prerequisite for East Asian financial cooperation; building the cross-border bond market in East Asia indispensable. But, when we see the financial systems of East Asia, we will note small businesses, medium-sized and small enterprises, particularly, in rural areas, where it is difficult for them to raise funds even from commercial banks.

To address this issue, this paper discusses and proposes consolidation of the bond markets of individual countries, supporting venture businesses in local areas, in view of the aims of significant financial reforms (Japan and China); role of microfinance institutions, e.g., the Grameen Bank in Bangladesh; Asia Regional Agricultural Credit Associations (APRCA) in Indonesia; rural credit cooperatives in China; and agricultural cooperatives in Japan.

1. Introduction

Countries in East Asia and Japan have been undergoing financial reforms. This is to strengthen financial systems by the disposal of bad loans which came about as a result of the currency crisis and with monetary liberalization and globalization. These reforms led to renewed cooperation through the bond market, for example, the Asian Bond Fund (ABF); and has became widespread in East Asia.

The bond market consolidation has been an indispensable cause of East Asian countries not only to move their funds within their respective region, but to strengthen their financial systems as well. This strong prudential regulation and supervision has been seen as the basis for building a free, fair and transparent financial system needed to stimulate the movement of funds within the region. We see then that financial systems of Japan and countries in East Asia, where the banking sector has played a significant role, are now moving into a new system whereby depositors and investors have been placed under a check, in other words, a condition where the market- oriented indirect financial system has had bond markets complementing the banking sector.

This consolidation has been a catalyst in enlarging the bond market. Recently, we have witnessed the regional financial systems as individual countries begin to consolidate by means of nonprofit organizations (NPOs) ; non-governmental organizations (NGOs); self-help financial groups; private and public financial institutions, and so on. However, market-oriented indirect financial systems, where government bonds, local bonds and investment trust fund channels linking cross- border bond markets; and regional financing of individual countries, might come out only when the regional financing of individual countries are consolidated. This paper, then, will consider fund channels linking cross-border bond markets and regional finance in individual countries, focusing mainly the on Japan and China.

To do this, we will first overview, in section two, the financial systems of East Asian countries. Section three will discuss financial reforms after 1990s in China and Japan, in light of the effect on organizations, disposal of bad loans, and consolidation of securing markets. Section four will analyze the necessity to consolidate bond markets, possibly leading to financial cooperation. Specifically, this section will consider the possibility of establishing cross-border bond markets; for example, the Asian Bond Fund (ABF); the Asian Bond Markets Initiative (ABMI), by examining the underlying factors that hindered the development of bond markets and by thinking methods of overcoming these obstacles. Finally, section five will discuss the possibility of building up regional finance and bond markets in individual countries, after analyzing the role of played by microfinance, essential for fund- raising by small- and medium- sized companies and small businesses. In addition, section five will make some proposals.

2. Asian currency crisis and financial reforms

2.1. Financial structure in East Asia and the ABF

The need to reform capital in the East Asian region has already been pointed out. Although the ABF was the first step in that direction, we could surely see that this financial product was the result of the Asian currency crisis.

As Yoshitomi (2003) has insisted, the factors which brought about the Asian currency crisis were a double mismatch -- a mismatch of term and currency.[1] In other words, there are two kinds of mismatches which resulted in the weakening of the flow of fund: one is the term mismatch, which made it difficult to withdraw credit, used for long-term investment in stocks and real estate once the inflow of short- term funds stops. The other is the currency mismatch, which increases liabilities in US dollars, when the exchange rate in the home country decreases. It was here that the necessity to consolidate financial and capital markets, which exploit and manage the risky capital accompanied by globalization came to light.

Rhee (1999) insisted that the delay of development of bond market caused local firms to rely on the off- shore market, and helped bring about the Asian currency crisis. As the monitoring and corporate governance weakened, this caused a disconnect between household savings and productive investment, and thus we can see how important the expansion of bond market has become.[2]

Let us examine then the characteristics of the banking structures and monetary policies of China, Korea and Japan, as well as the four countries of ASEAN -- Indonesia, Malaysia, the Philippines, and Thailand as of 1998, when the significance of bond market as a result of the Asian currency crisis, became apparent.

Table 1 shows the following : (1) from standpoint of the scale of banks, Japan stood out, with 116 banks, represented within the 1,000 largest banks in the world; (2) from the concentration in banking ,i.e., the combined share of five largest banks considering total assets, China and the Philippines has high figures at 70 and 60 percent, respectively; meanwhile, Japan had the lowest figure of 22 percent; (3) from the claims against government, the highest was 23 percent of the Philippines, while Thailand, China, Indonesia, and Korea had low figures; (4) proportions of banking sector assets, out of total financial assets, varied from 91 percent for Indonesia (the highest) to 38 percent for Korea (the lowest); (5) likewise, proportions of state-owned banks varied from 99 percent for China (the highest) to 7 percent for Malaysia (the lowest); (6) similarly, proportions of foreign banks assets varied from 20 percent for Malaysia the highest to nil for China the lowest ; (7) the Philippines received the highest rating by Moody's, while Indonesia received the lowest.

Looking at the above, the financial assets of banks accounted for an overwhelming proportion of total assets in the financial systems of China and the ASEAN countries. Here, an executive of a business corporation would typically be relying on bank borrowing as the major source of outside financing. In contrast to financing in the capital markets, where the executive is subject to monitoring by shareholders and the majority of profits paid out as dividends, the executives tends to engage in more risky investment ventures in the absence of shareholder monitoring. Beyond that, mostly, in countries like China or Indonesia-- where most commercial banks are owned by the state-- there is increased likelihood of moral hazard and rent- seeking, which would deteriorate the managerial efficiency. Such a situation calls for a system such as bond markets to monitor the behavior of banks and borrowers.

2.2. Financial reforms

Although the consolidation of cross border bond market would advance the financial cooperation in East Asia, it would be a precondition to construct a domestic financial system which can support financial liberalization and globalization.

To better consider this, let's look over the recent financial and capital markets of China, Korea, Japan and ASEAN 4. **Table 2** illustrates the following: (1) outstanding bank loans exceeded outstanding corporate bonds and equity market capitalization, except Korea and the Philippines, as of 2001; (2) all outstanding bank loans, outstanding corporate bonds and equity market capitalization increased from 2001 to 2006. But in contrast to Korea whose equity market capitalization showed a higher increase rate than the one of outstanding bank loans and outstanding corporate bonds, China and Japan, especially, China's increase rate of outstanding corporate bonds was remarkable; (3) it is clear that outstanding bank loans are largest, except Indonesia, Malaysia and the Philippines, even in 2006. But as the share of outstanding bank loans accounts for, respectively, 48.2 percent for China, 43.1 percent for Japan, 35.4 percent for Korea, it can be thought that the financial reforms in the banking sectors have to come first in order to enlarge bond markets. Concomitantly, the consolidation of the regional finance of individual countries recently have been adopted as an important policy purpose, would contribute to mobilizing the savings of household and expanding the bond markets. Now, let us consider mainly the financial reforms of China and Japan, whose outstanding bank loans have largest shares, including the issues of regional finance.

2.2.A. Financial reforms in China

China has promoted financial reforms, whose purpose is to build up rules based on international criterion and the financial institutions with strong international competitiveness, since 2001, under the recognition that she must open the financial sector as a member nation of the World Trade Organization (WTO). But, on the other hand, foreign banks had not been allowed to deal in renminbi (RMB) until 1999, so that the emergence of the bubble and bad loans were not unlikely to have been influenced by the inflow of foreign funds. It might be considered that China's biggest problems are the delay in the reform of state-owned enterprises (SOEs), which used to play the leading role within Chinese industries, and massive bad loans that have been accumulated by the SOEs.[3]

Therefore, in order to improve business operations improve by avoiding the intervention of SOEs, the Chinese government began to fortify the supervision capabilities of the three major supervisory authorities, namely: the People's Bank of China (PBC), the China Insurance Regulatory Commission (CIRC), and the China Securities Regulatory Commission (CSRC). Likewise, the financial reform of 1999 was aimed at making changes in the organization of the central bank as well as of the state-owned banks, and the disposal of bad loans.[4]

First, with regard to the organizational changes, the PBC headquarters was given the task of executing the monetary policies, while its local branches were assigned to carry out financial supervision, in a "division of labor." This separation of functions was aimed at securing the smooth transmissions of monetary policies and strengthening risk management, as was the privatization of the state-owned banks. Secondly, in an effort to dispose of bad loans, separate asset management companies were established to handle bad loans of the four major state - owned banks, namely, the Industrial and Commercial Bank of China, China Construction Bank, the Agricultural Bank of China, and the Bank of China. In addition to boost the capitalization of these banks, special government bonds were issued. Further, the reconstruction of banks was implemented to dispose of bad loans of NBFIs and small-and medium- sized companies. Third, securities companies and asset management companies were allowed to participate in the inter-bank securities market, seeking to foster development of the domestic securities markets.

But the issues on China's financial liberalization and financial reforms can not be considered without referring to development pattern of China. The main targets of financial reform since 1993-- aimed at constructing the market-oriented managerial system-- were the separation of policy loans and business loans, establishment of policy banks, privatization of state-owned banks.

Financial reform extended to the local financial system from urban one.[5] From the standpoint of commercial banks, not only the nationwide commercial banks, but also local banks stressing urban credit cooperatives were established in urban district. Likewise, rural credit cooperatives themselves were reorganized in a rural district. Although rural finance consists of the Agricultural Development Bank of China as policy making financial institution; the Agricultural Bank of China as the commercial bank; rural credit cooperatives as cooperative financial institution; rural credit cooperatives, originally separated from the Agricultural Development Bank of China, twice, in 1994 and in 1996. But in contrast to the Agricultural Development Bank of China, that is, in the same category as an urban commercial bank, in the sense that they provide relatively, large-scale funds, rural credit cooperatives have a role as micro financial institutions which lend to small- scale borrowers such as cottage industries in rural area, which find it difficult to get financing in commercial sector.

However the management of most rural credit cooperatives is in severe managerial crisis. In order to deal with this situation, although they have begun merging, the obscure ownership makes insider-control difficult. Therefore an adequate combination between corporate financing which pursues market economy, and cooperative financing, combining reciprocal help, become other subjects.

2.2.B. Financial reforms in Japan

As demonstrated by its significant financial reform, the Japanese version of the "Big Bang" in November 1997, the financial reforms of Japan in 1990s were driven by a combination of two purposes, namely: further promotion of financial liberalization and prompt disposal of bad loans accumulating since the bursting of the bubble economy and revitalization. To execute this, a supervisory agency was established in 1998, and reorganized into the Financial Services Agency (FSA) in July 2000. [6]

However, along with an improvement of financial environment, the FSA provided the "Program for Further Financial Reform" -- Japan's challenge: Moving Toward a Financial Services Nation-- in December 2004. That program suggested a change in the monetary policies of Japan, from the emergency reaction phase to a more desirable financial situation. Also, it meant an accelerated shift from savings to investment by forming the internationally attractive financial market, and a shift from the money flow, which had been too centered on indirect finance to direct finance and/or market- based financing, which could offer options for diversified and high-quality financial products and services to people on his own risk.

Therefore, this program can be thought to create a financial reform as a part of the overall structural reform in order to deal with aging population and further globalization. In the case of corporate governance of citizens' deposits and investments, this program provided the following measures: (1) emphasis on user's needs and thorough implementations of user protection rule, and (2) the establishment of a reliable financial administrations, e.g., improving transparency and predictability of the financial administration and the promotion of a convenient and efficient financial administration.

During this period, the reform of security markets was performed. For instance, the program to promote the reforms of security markets, announced by the FSA in August 2002, aimed the establishment of the reliable market in which various investors could participate. Above all, in order to gain approval of investors, policies such as: reinforcement of the function of the securities investment committee; improvement of accounting and audit; intensification of disclosure; and performance of corporate governance were adopted.

On the other hand, considering the contribution to regional economies, the "Action Program Concerning Enhancement of Relationship Banking Functions (2005-2006)" has been implemented. Since this program became a region-basic banking system, the following policies were enacted: (1) a revitalization and activation of regional economies, (2) facilitation of small-and medium -sized enterprises financing; and (3) strengthening of the management function of regional financial institutions.[7]

3. The global bond market and regional economies of individual countries

Since it has been suggested by the financial reforms of China and Japan, we can now take a note that the corporate governance, by which stockholder and investor can directly check financial and capital markets, have been brought into sharp focus; and instead of industrial finance, regional finance of the individual countries have been dealt with. It can be further noted that there has been a possible increase in the development of the bond market, insofar as the welfare of households is concerned.

Here let us consider some policies to expand the bond markets as seen from two angles: (1) the consolidation of cross –border bond market; and (2) the activation of regional finance of individual countries.

3.1 Consolidation of the cross-border bond market

The expansion of the corporate bond market ought to be a significant factor from the standpoint of the vitality of the private sector. Yet it will be difficult to determine that the private bond market has been developed globally, as suggested by the direct foreign investment by Japanese firms. For example, in view of investment by Japanese manufacturing in the invested country or region, the funds that they raised by issuing corporate bonds in the local countries were limited in the EU, NIEs and the U.S. at end of March 1999. Moreover even the EU, showing the highest ratio, was only 5.2 percent, followed by the NIEs of 3.1 percent and the U.S. of 0.9 percent.[8]

As for the reason trading in the bond market was restrained, we can see that the issues of weak market mechanism and the limited supply of bond instruments were factors. The former issue resulted from the lack of reliable benchmark yield curves, which initially should have been the investment criterion. This is in contrast with the success story of the Exchange Fund Note Program, as executed by the Hong Kong Monetary Authority (HKMA) in 1993; the bond market of China stagnated because she did not issue bonds with the benchmark yield curve. From this situation, the necessity to overcome the weakness of market mechanism would be a significant factor.[9]

On the other hand, taking into account the limited supply of bond, (1) the delay to consolidate primary and secondary markets can be attributed to the following: (a) the differences in yield between the demand for bonds by the primary and secondary markets; (b) the captive condition in the primary market lowered the yield of pension funds of financial institutions and non-bank financial institutions; (c) competitive auctions, real-time price and volume information, bond clearing and settlement, hedging in interest rate risk, and the function of credit-rating agencies.

(2) As for the legal system, there were the following delays: the enactment of a law to stipulate the indebtedness of firms, legal protection of investors, and the establishment of lawsuit system for bankruptcy. Conversely, the repressive regulations had been executed, as shown, in order to oblige commercial banks to hold government bond or state

enterprise bond in exchange for permission to establish a new branch. (3) Considering the expenses for fund raising, the cost incurred from borrowings from banks was rather cheaper than issuing bonds, and this has stood in the way of the development of the bond market.

The policies of expanding the bond market by overcoming the above issues have now been implemented. To begin with, as for the development of the domestic bond market, the policies to consolidate primary and secondary markets are follows:

(1) In the primary market, the financial instruments, namely, governmental bonds to create benchmark risk-free interest rates and yield curves have already been introduced. In addition, according to the implementation of competitive auction rules, the rate of yield results to be decided by the supply-and- demand condition of the credit market. Therefore, this will be needed to enhance market mechanism by limiting the participation of a large number of small issues and establishing a primary dealer system. And it will be needed to create benchmark interest rates by issuing mortgage-backed securities, even if the issue of government bond might be difficult.

（2） In the secondly market, there exist the following factors lowering liquidity: (a) investors of bonds usually hold them until maturity; (b) price and volume information is not made available in real time; (c) there are no market-markers; (d) the credit-rating system is weak. Therefore, the following policies to remove these issues ought to be proposed: (ⅰ) the expansion of repo markets; (ⅱ) the consolidation of inter dealer broker markets to enhance liquidity and transparency; (ⅲ) the elimination of captive demand for government-issued securities; (ⅳ) improvement of bond clearing and settlement systems.

Secondly, the Asian Bond Fund (ABF) was initiated for the consolidation of cross-border market by the Executive Meeting of East Asia and Pacific Central Banks (EMEAP) in June 2003. This project, called ABF1, was extended to ABF 2 in May 2005. This step not only made the investment in local currency possible, but also made it possible for the retailers and, ultimately, the public to purchase the bond, different ABF1, which restricted the investors to the central banks of EMEAP.

Further, other than the above ABF project, ASEAN + 3 (China, Japan, Korea) Finance Ministers have implemented the Asian Bond Markets

Initiative (ABMI) since 2003. The purpose of this project is to improve the regulation and infrastructure of various fields such as securitization, credit guarantee, rating institutions, exchange and capital regulation, and securities settlement by complementing the ABF.

As for the cross-border transaction, local foreign investment is especially important-- the salient point being whether the foreign investors are permitted to buy the local bond. For example, according to the survey jointly executed by the Bank of Japan and Bank Negara Malaysia,[10] there exist some restrictions.

Actually, the Qualified Foreign Institutional Investor (QFII), which China adopted in December 2002, has resulted in the following issues: (1) Subject to the trade via Chinese security companies after opening special reminbi (RMB) accounts at local financial institutions in China; (2) Restraining the ability of fund managers by prohibiting the carrying out profits of investments overseas for three years by closed- end investment and for one year by the other type of investments after opening; (3) doubtful transparency on the approval of a QFII license.

On the other hand, looking at the case in Japan, foreign investors have been able to purchase Inflation-indexed Government Bonds since the revision of the law in April 2005, when they filled certain conditions provided by the government, and also the procedure for tax-exemption have been simplified. The problem still exists of slow response to the questions by the tax office.

3.2 Fund channels to stimulate the region

The consolidation of the primary and secondary bond market will promote the investment in the home country by foreign investors. Concurrently, it is becoming indispensable to build fund channels through which the cross-border bond market can favor the small business, and medium-sized and small companies in rural area, because even the access to the commercial banks is actually difficult.

The fact is that small business and medium-sized and small enterprises can not efficiently raise funds; and this depends upon high transaction costs and risks accompanied by loans to smaller businesses that are not the target of policy loans. The high credit risk is attributed to lack of information, collateral shortage and unclear accounting books of borrows under the inefficient regal system to determine bankruptcy. On the other hand, the high transaction costs are due to lenders not being able to enjoy a scale merit because smaller businesses are inefficiently scattered throughout rural areas. Under this situation, the fund raised by smaller firms, therefore, rely on own funds, borrowings from the informal sources (e.g. relatives, friends, money lenders, mutual savings and loan institutions such as rotating credit associations.

The financing of smaller firms and rural financing in China are facing a common issue with other East Asian countries.[11] First, with China, medium-sized and small enterprises that are synonymous with non-government enterprises consist of township and village enterprises, personal companies and foreign affiliate. Although the lending ratio of commercial banks to the medium-sized and small enterprises has been accelerating since 2001, the reason is based on increased financing to the good medium-sized and small enterprises, in contrast with the ratio of bad loans of large enterprises, in effect, government enterprises have been increased. But it can not be denied that, as the size of enterprises become smaller, not only the ratio of lending to medium-sized and small enterprises will decline, but also the dependence on short-term fund will increase. Incidentally, the ratio of dependence on short-term fund was, 39.6 percent for large-sized enterprises, 44.9 percent for mid-sized enterprises and 48.9 percent for small-sized enterprises at the stage of 2003.

Second-- in the rural finance of China-- we find formal financial institutions: the Agricultural Development Bank of China and rural credit cooperatives; informal financial institution (such as mutual savings and loan associations); and relatives and friends. Above all, rural credit cooperatives are the largest financial institution in the rural area. Since rural credit cooperatives gave way to bad loans in the 1990s, the management system has been reconstructed with an aim toward clearing the financial standing and improvement of corporate governance.

Rural credit cooperatives are an example of microfinance. The purpose of microfinance was originally to facilitate fund raising and investment in the agricultural sector, household and medium-sized and small enterprises that lagged behind in the industrialization, while it also can be seen that the agricultural cooperatives in Japan have been playing an significant role in microfinance as well. Financial institutions that are representative of microfinance are the Grameen Bank (a kind of nongovernmental organization (NGO) in Bangladesh), and the Asian Pacific Regional Agricultural Credit Association (APRCA) in Indonesia.[12] These two financial organizations have been in the limelight since the 1980s.

With the advent and development of people's organizations, NGO and non-profit organizations (NPOs), the purpose of microfinance has changed from that of supplying low -interest credit and subsidy for the poor to that of constructing the financial system which can provide financial services to meet diversified financial needs. It is here that current profits to own capital (ROE) and current profits to assets (ROA) have emerged as important as indexes by providing a nexus to the existent self-help groups such as the market mechanism. By this process, mobilization of savings and credit supply has been devised to link up the existent self-help groups as intermediaries between grass- roots organization and banks.

The examples of Grameen Bank and APRCA suggest the possibility to link the so far indirect financial system and the bond market. The concept of grass- roots financial institution can be applied not only to the developing economies, but also to the developed countries. In fact, in the case of Japan, the local enterprises started from local area such as Advantest Corporation, Shima Seiki Mfg., and Ltd. And Kitanihon Seiki Co., Ltd. developed to sweep the global niche market, where regional finance might contribute to the fund raising of these venture business.[13]

To consider the role of microfinance, let us examine its type by using the following criteria: [14] (1) whether or not a micro finance institution (MFI) takes deposits from the general public; (2) its size; (3) its legal constitution. There are three types of MFIs: (a) member-based, ranging from informal solidarity or self-help groups, and rotating savings and credit associations (ROSCAs), through credit unions and other mutual forms of ownership to cooperative banks; (b) various types of NGOs, including some non-profit companies; (c) commercial companies, from finance companies to banks. Moreover, the MFI of the last type can be classified into profit-making MFIs and non- profit-making MFIs. However, when the profit-making MFIs link up with non-profit-making MFIs, the two types of MFIs can be linked through intermediation of banks.

When this situation exists, the linkage between self-support group and banks, between savings and loan organizations emerge, while the institutional linkage itself is categorized into three models: (1) the indirect model (micro enterprise - self-support group — private voluntary organization — bank) , (2) direct model (micro-enterprise - self-support group — bank), (3) direct access model (micro-enterprises - bank). The institutional linkage between bank and self-help group may proceed from indirect to direct linkages and from direct linkage to direct access. Still, this process is subject to the following conditions: (1) savings is treated as collateral; (2) loans from banks need formation of group; (3) the criterion of savings and loans are contingent upon market interest rate; (4) importance is placed upon solidarity guarantee; (5) procurement of interest and charges is required.

As shown in **Figure 3**, the linkage between local banks and large enterprises may be formed, accompanied by the expansion of scale of enterprise. In addition, the intensification of this relationship may lead to a coexistence of the linkage between foreign affiliates and foreign banks, and the one between foreign affiliates and bond market.

In fact, in Japan, new kind of bond has appeared enabling the flow of funds from region to region, reverting to a market-oriented indirect finance system. For example, the citizen participatory-type public market offering bond which has been issued since 2002 in the local area, for specific purposes, namely, nature conservation; this is a good example of a new kind of bond. And it can be expected to stimulate regional finance, while the Japan Government Bond (JDB) for individual investors, called “kojinkokusai” which has been issued since 2003, may contribute to market-oriented indirect finance system.[15]

Other than Japan, in the other East Asian countries where the rate of reliance on government bonds is high, corresponding to the delay in the development of corporate bonds, the intermediate involvement of NGOs or self-support groups will play a significant role in encouraging market-oriented behavior of medium-sized and small enterprises and households. And it can be considered that, at the next stage, along with the advance of the regions’ development, nationwide and, moreover, global networks will be created.

In order to develop the capital markets of East Asian countries, accelerating the financial project for venture business as well as establishing the bench mark, expanding the repo-market and strengthening public and corporate bond market seems indispensable. Significantly, the recent tokumei kumiai (anonymous partnership), raising funds from the general investors, have been brought into focus, and the policy to buttress the stimulation for businesses has been become significant. By inaugurating the fund channels, whereby citizens can invest in local enterprises, the discipline and liberalization of municipal bonds will take a paramount position.

4. Conclusion

The purpose of this paper was to consider the necessity of consolidating the bond market prior to the constructing an Asian Common Market.

Reflecting on the Asian currency crisis, the East Asian countries, including Japan, are placing importance on consolidating their financial infrastructures as well as the flow of the regional fund within their region. From the recognition that the consolidation of bond market to complement the financial system led by banks is indispensable for strengthening prudential regulation and supervision to protect the investor’s interest, the cross-border bond market, such as the ABF and the ABMI have been constructed.

Accordingly, the consolidation of the primary and secondary bond markets and corporate governance should be strengthened. But, in considering the bond market, we should take note that there are small businesses that can not raise the fund even from commercial banks, while cross-border markets have been consolidated. Namely, it can not be denied that large enterprises with international competitiveness and small businesses that find it difficult to enjoy the fruits of globalization coexist.

However, we can find the possibility of linking large enterprises and small businesses in the example of micro finance, represented by APRCA and Grameen Bank. These financial institutions exist in alleviating information asymmetry by forming a guarantee of solidarity and, as a result, reduce transaction costs. In fact, as the financial trade, based on the market mechanism has begun to take hold by the intermediation of NGOs and non-profit organizations (NPOs) and self-support groups, the linkage between these units and regional enterprises and financial institutions, should, we think, be deepened.

Thereafter, we can expect that the financial systems of East Asian countries will be developed in time, namely, from (1) the system which microfinance is main player to (2) the system which public and commercial banking systems are main player, and further, to (3) the system completed by investment trust and bond.

In fact, as the example of Japan, once the bond, based on the regional economy is issued, the possibility of the coexistence with the cross-border bond is enhanced. Moreover, when the venture businesses or, medium-sized and small enterprises in the region flourish in the global market, the regional bond market will be linked with the cross-border bond market as well as the stock market. However, as capital market will accompany risk, the reinforcement of market function, accompanied by the adequate prudential regulation such as disclosure of balance sheet guaranteed by the reliable rating institutions. But in order to bring this about, the reinforcement of the citizen's checking function through the bond market will become essential. And the citizen's participation in the bond market can be expected to drive the financial cooperation in East Asia.

NOTES

1. See, Yoshitomi, M. (2003), 50-52.

2. Rhee, S.G. (1999), 14-21.

3. As for the process of the financial reform of China, see, Tamaki, T. and Yamazawa, K. (2005), 16-19 and 150-185.

4. See, The People's Bank of China (2000), pp. 14-15 and Takahashi, Y. (1997), 26-33.

5. See, Wei, R. (1997) , 64-65 and Wu, J.（2004）,219.

6. Financial Services Agency, Website, http// www. Fsa.go.jp/

7. Small and Medium Enterprises Agency (2007), 128-155.

8. Ministry of Economy, Trade and Industry (2001), 731- 748. For the direct investment by Japanese firms, also, see, Kishi, M. (2002), 731-748.

9. See, Rhee, S.G. (1999), 114-121.

10. See, Takeuchi, J. (2006), 35-41.

11. See, Tang, C. (2005), 169-181.

12. See, Seibel, H.D. and Parhuship (2003), 11-36.

13. The example of the U.S. community banks: The importance of a region-based banking system. Yuri, M. (2001), 26-28.
In addition, for the Japanese, see, Shimada, H. (1999), 1-52.

14. Fisher, T., Bush, M., and Guene, C. (2000), 2-35.

15. See, Niwa, Y. (2005). 209-211. For the participation of citizens and households, namely, inhabitants of the community, see, Kishi, M. (2005).

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Table1. Structure of the banking industry at the end of 1998

	China	Korea	Japan	Indonesia	Malaysia	Philippines	Thailand
Number of large and medium domestic banks ranked in world's top 100	7	14	116	---	15	14	9
Concentration in the banking Industry(%)	70	50	22	---	40	60	62
Bank claims on government (%)	2	3	11	3	7	23	0
Share of bank assets in total financial sector assets (%)	78	38	48	91	78	---	77
Share of state-owned banks(%)	99	28	15	85	7	---	29
Share of foreign-owned banks(%)	0	6	2	---	20	---	13

Source: Hawkins, J and Philip, T. (1999). p. 9.

Table 2. Loans, Equities, and Bonds

(a) at the end of 2001 (Billions of U.S. dollar)

	Outstanding bank loans	Outstanding Equities	Outstanding corporate bonds	Total
China	1,605.1 (67.8)	524.0(22.1)	238.3(10.1)	2,367.4(100.0)
Korea	413.9(39.4)	220.0(20.9)	419.9(39.7)	1,050.8(100.0)
Japan	8,527.5(53.0)	3,157.2(19.6)	4,412.(27.4)	16,096.8(100.0)

(b) at the end of 2006

	Outstanding bank loans	Outstanding Equities	Outstanding corporate bonds	Total
China	3,510.0 (48.2)	2,426.3 (33.8)	1,350.6 (18.5)	7,286.8(100.0)
Korea	984.0 (35.4)	835.2(30.1)	959.0 (34.5)	2,778.2(100.0)
Japan	8,978.4 (43.1)	4,736.5 (22.8)	7,096.1 (34.1)	20,811.0(100.0)

Note: Figures in parentheses denote percentage for total external funds.

Source: Takayasu, K. (2007). p. 18.

Figure1. Fund channel to link financial institutions, bond market and microfinance