

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

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# 1. Purpose

- Consideration of fund channels linking cross-border bond markets and regional finance in individual countries, focusing mainly on Japan and China

# 2.1. Financial structures in East Asia and the ABF

- Reflection of the Asian Currency crisis
  - Double mismatch brought about the Asian currency crisis
    - term mismatch      currency mismatch
  - Delay of development of bond market
    - Rhee (1999)      Yoshitomi (2003)
- Consolidation of bond markets
  - Renewed cooperation through bond market
    - ABF1      ABF2      ABM1
  - Necessity of consolidation of bond market
  - Market-oriented financial system complemented by bond market

## 2.1. Financial structures in East Asia and the ABF (2)

- Characteristics of the banking structures and the monetary policies of China, Korea, and Japan as well as the four countries of ASEAN (Indonesia Malaysia the Philippines Thailand) as of 1998 [Table1]
- Scale of banks
- Concentration in Banking
- Claims against government
- Proportions of the banking sector assets
- Proportions of state-owned banks
- Proportions of foreign bank assets
- Moody's rating

# Table 1. 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.

## 2.2. Financial reforms

- Although the consolidation of cross - border bond markets would advance financial cooperation in East Asia, it would be a precondition to construct a domestic financial system which can support financial liberalization and globalization
- Financial and capital markets of China, Korea and Japan and the ASEAN4 as of 2001 [Table 2]
  - Outstanding bank loans
  - Outstanding corporate bonds
  - Equity market capitalization

# 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 financing.

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



## 2.2.A Financial reforms in China

- Delay in the reform of state-owned enterprises (SOEs)
  - Fortification of supervision capabilities of the People's Bank of China (PBC), the China Insurance Regulatory Commission (CIRC), and the China Securities Regulatory Commission (CSRC)
  
- Financial liberalization and financial reforms since 1993
  - Separation of policy loans and business loans
  - Establishment of policy banks
  - Privatization of state-owned banks
  
- As for local financial system, reorganization of rural credit cooperatives, the Agricultural Development Bank of China, the Agricultural Bank of China
  - Significant role of rural credit cooperatives as microfinance institution, although most of them are in a severe management crisis

## 2.2.B Financial reforms in Japan

- The Japanese version of the “Big Bang” in 1997
- Establishment of a supervisory agency and reorganization into the Financial Services Agency (FSA) in 2000
- The “Program for Further Financial Reform”— Japan’s Challenge: Moving Toward a Financial Services Nation in 2004
- As for regional economies, the “Action Program Concerning Enhancement of Relationship Bank Functions (2005~2006)

### 3. Global bond market and regional economies of individual countries

- Indispensable conditions to expand bond markets
  - Construction of cross-border bond market
  - Activation of regional finance of individual countries

## 3.1. Consolidation of the cross-border bond market

- What is the reason to restrain the trading of corporate bond ?
- The issues of weak market mechanism
  - Lack of reliable benchmark yield curves.
- The limited supply of bond
  - The delay of consolidation of primary and secondary markets
  - The legal delay such as the enactment of a law to stipulate the indebtedness of firms, legal protection of investors, and the establishment of lawsuit system for bankruptcy
  - The fact that the cost of borrowing from banks rather cheaper than the one of issuing bond

### 3.1. Consolidation of the cross-border bond market (2)

- Which kind of policies are needed to expand the domestic bond market?
- In the primary market
  - Introduction of the financial instruments to create benchmark risk-free interest rates
  - Enhancement of market mechanism by establishing a primary dealer system
- In the secondary markets
  - Expansion of repo markets
  - Consolidation of inter dealer broker market to enhance liquidity and transparency
  - Elimination of captive demand for government-issued securities
  - Improvement of bond clearing and settlement systems

### 3.1. Consolidation of cross-border bond market (3)

- The remaining problems
  - The problem of the Qualified Foreign Institutional Investor (QFII) in China, adopted in 2002
  - The problem of slow response to the questions given to the tax office in Japan in 2005
- Recent capital markets [Table 3] [Table 4]

# Table 3. Bond Issuance, 2002–2007

(In millions of U.S. dollars)

	2002	2003	2004	2005	2006	2007
China	340.0	2,039.2	4,888.1	3,953.9	3,184.4	6,489.4
Korea	9,071.5	11,880.1	17,529.2	19,426.9	20,422.2	25,376.5
Indonesia	275.0	609.0	1,363.5	3,217.7	2,000.0	2,200.0
Malaysia	1,280.0	1,142.5	1,414.5	2,303.1	3,510.5	1,936.7
Philippines	4,773.8	4,449.6	4,449.1	3,900.0	4,619.0	1,300.0
Thailand	48.0	300.0	1,400.0	2,242.6	1,179.0	766.2

Source: IMF (2008). Global Financial Stability Report.

# Table 4. Equity Issuance, 2000–2007

(In millions of U.S. dollars)

	2002	2003	2004	2005	2006	2007
China	2,475.0	6,501.4	14,326.2	25,741.4	41,623.6	36,972.6
Korea	1,553.7	1,222.6	3,223.3	7,814.9	7,329.8	3,503.2
Indonesia	281.0	1,096.7	535.2	1,283.5	665.9	2,090.2
Malaysia	888.4	618.1	887.2	735.2	217.3	1,097.5
Philippines	---	---	18.0	535.8	436.7	1,143.2
Thailand	56.3	1,011.6	1,098.4	479.7	1,772.4	---

Source: Same as Table 3.



## 3.2. Fund channels to activate the region

- It is becoming indispensable to build fund channels through which the cross-border bond market can favor small businesses, medium-sized and small companies in rural areas, because even access through them to commercial banks is actually difficult.
- The funds raised by smaller firms, rely on their own funds , borrowing from informal financial sources (e.g. relatives, friends, money lenders, mutual savings and loans or a combination of the above, including rotating credit associations.)

## 3.2. Fund channels to activate the region (2)

- The financing of smaller and rural financing in China
  - Medium-sized and small enterprises consisting of township and village enterprises, personal companies, and foreign affiliates
  - As formal financial institutions, the Agricultural Development Bank of China and rural credit cooperatives
  - As informal financial institutions, mutual savings and loan associations

## 3.2. Fund channels to activate the region (3)

- The example of microfinance:
  - Rural credit cooperatives (China)
  - The agricultural cooperatives (Japan)
  - The Grameen Bank (Bangladesh)
  - The Asia Pacific Agricultural Credit Association (Indonesia)

## 3.2. Fund channels to activate the region (4)

- The changing role of microfinance:
  - From supplying low-interest credit and subsidy to construction of the financial system, which can provide services to meet diversified financial needs
  - By this process, mobilization of savings and credit supply have been devised to link the existent self-help groups as intermediaries between grass-roots organizations and banks

## 3.2. Fund channels to activate the region (5)

- The term "grass-roots financial institution" can be applied not only to developing countries, but also to advanced countries.
- Local enterprises started from local area and now have sweeping global market
  - In the case of Japan, the Advantest Corporation, Shima Seiki Manufacturing, Ltd., Kitanihon Seiko Co, Ltd.

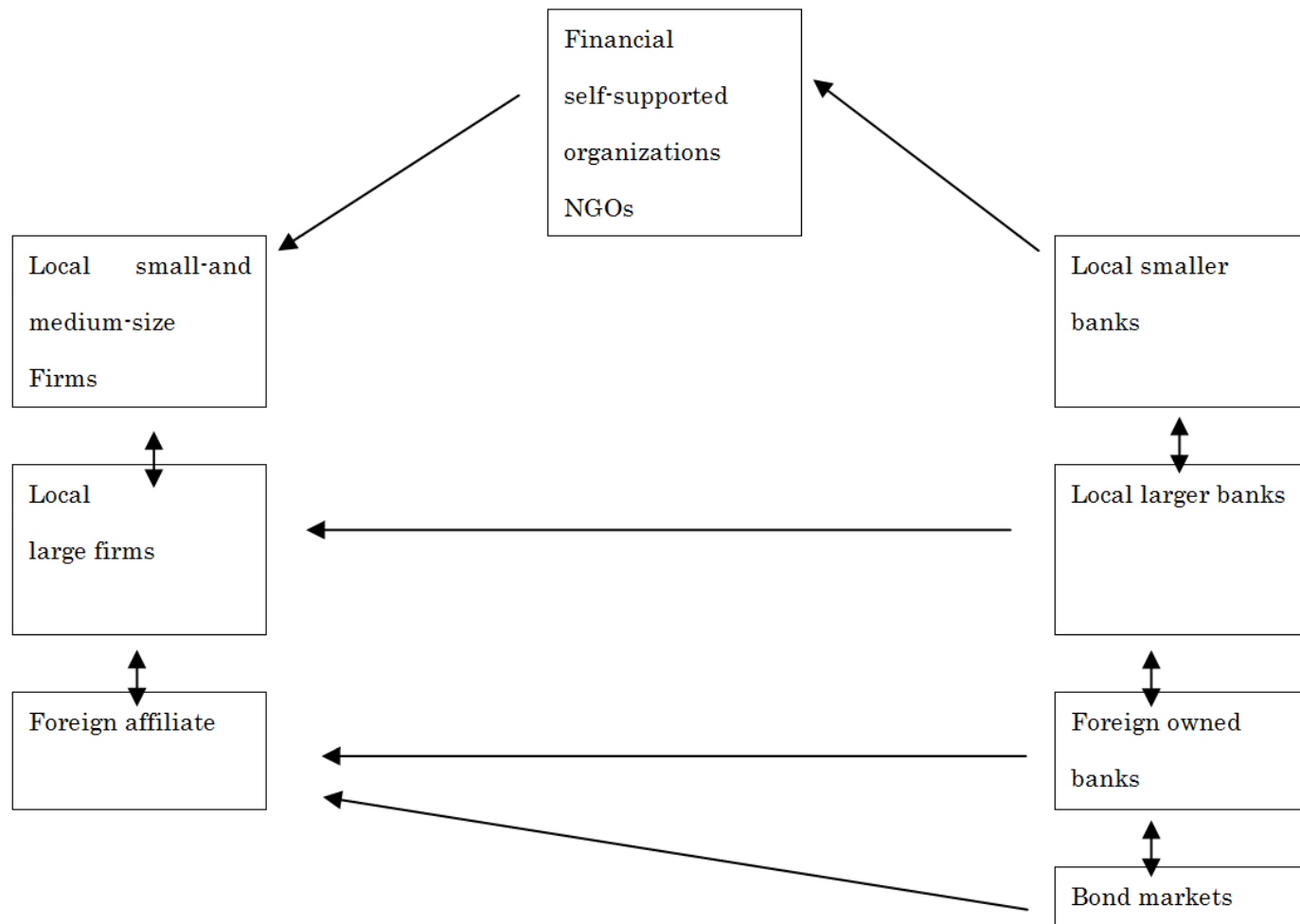
## 3.2. Fund channels to activate the region (6)

- Three types of microfinance institutions
  - (a) Member-based, ranging from informal solidarity or self-help groups, and rotating savings and credit associations, through credit unions and other mutual forms of ownership to cooperative banks
  - (b) Various types of NGOs
  - (c) Commercial companies, from finance companies to banks

## 3.2. Fund channels activate the region (7)

- The three models of linkage [Figure 1]
  - (a) The indirect model (micro enterprises – self-support group- private voluntary organizational bank)
  - (b) The direct model (micro enterprises – self-support group – bank)
  - (c) The direct-access model (micro enterprise – bank)
- The process of institutional linkage from direct to indirect linkage , and from direct linkage to direct access

Figure 1. Fund channel to link financial institutions, bond market and microfinance





## 3.2. Fund channels to activate the region (8)

- The possibility of coexistence of the linkage between foreign affiliate and foreign banks, and foreign affiliate and bond market
- The appearance of new kind of funds
  - The citizen-participatory type public market-offering bond (issue in Japan since 2002)
- Acceleration of the financial project for venture businesses
  - The tokumei kumiai (an buttress partnership) raising funds from general investors

# 4. Conclusion

- Precondition for the construction an Asian Common Market
  - Consolidation of the bond market
  - Consolidation of financial infrastructures and bond markets of individual countries as well as cross-border market

# 4. Conclusion (2)

- Some Proposals
  - Necessity to consider not only the bond market but also the fund channel for smaller enterprises
  - Necessity to consider the role of microfinance and linkages between regional enterprises and financial institutions, and NGOs, NPOs, and self-support groups
  - Necessity to consider the possibility to expand the fund channel for venture business by issuing bond