

**TRADE IN BANKING SERVICES
IN ASEAN COUNTRIES**

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ABSTRACT

The study examines the issues on trade in services in ASEAN countries for a continuous and more effective series of multilateral negotiations. The issues in the negotiations revolve around the gradual dismantling of barriers to trade in services that would ultimately benefit both developed and developing countries. Primary focus was given on the financial sector. The paper analyzes, in the context of the ASEAN countries, various aspects which are considered relevant to these negotiations. It also explores the possibility of expanding trade in banking services as a means to achieving higher and sustainable growth in these countries. This analysis begins by first examining the scope of banking activities in the region. Emphasis is then given to the structures of markets and competition of the ASEAN banking system. This is followed by an enumeration of the benefits and costs towards a more liberal regime for international trade. It proceeds to discuss the implications of the key concepts and principles in the multilateral negotiations on trade in services to the banking sector in the ASEAN countries. The paper ends by discussing the possibility of increasing the competitiveness of banks in the region and subsequently their share of international trade in banking services through such measures as regional cooperation and the Uruguay Round of trade negotiations on services.

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TRADE IN BANKING SERVICES IN ASEAN COUNTRIES*

Mario B. Lamberte**

I. INTRODUCTION

Since its establishment in 1967, ASEAN has enjoyed regional peace and stability. This has been translated into high economic growth most envied by other regional groupings. ASEAN is, however, composed of fairly heterogeneous countries in terms of level of development and degree of sophistication of their economy. Singapore belongs to the so-called "newly-industrializing economies" (NIEs). Its per capita GNP in 1988 is more than 20 times higher than that of Indonesia, which has the lowest per capita GNP in the region. It was also the fastest growing ASEAN member country in the 1980s (see Table 1). Thailand's economic growth in the 1980s was phenomenal. This is likely going to be sustained in the early 1990s when the huge foreign investments it received in the late 1980s are translated into increased productive capacity. In contrast, the Philippines has a lot of catching up to do in the 1990s. The political and economic turbulence it encountered through much of the 1980s practically set back its clock of development to the 1970s. Its huge debt overhang will continue to constrain its growth in the medium term.

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Table 1
BASIC INDICATORS: ASEAN

INDICATORS	Indonesia	Malaysia	Philippines	Singapore	Thailand
1. Per capita GNP: 1988 (US\$)	438	1,878	638	9,188	1,888
2. Ave. growth rate per capita GDP: 1981-89 (%)	2.4	2.2	-0.9	4.7	4.6
3. Ave. GDP growth rate: 1981-89 (%)	5.2	5.4	1.8	6.9	7.1
4. Broad money/GNP (%)					
4.1 1988	13.2	69.8	19.8	94.4	37.3
4.2 1987	26.9	124.3	28.7	184.8	64.9
5. Sectoral shares of GDP: 1989 (%)					
5.1 Agriculture	28.5	28.2	26.9	8.4	15.9
5.2 Industry	48.3	41.8	33.1	36.6	33.9
5.3 Services	39.3	38.7	48.8	63.8	58.5
6. Share of services in Employment: 1986 (%)	35.8	53.8	48.8	61.8	25.8

Sources: Lines 4 and 6 from the World Bank's World Development Report (1989) and Quibria (1989), respectively; and the rest from Asian Development Bank's Asian Development Outlook (1998).

Financial deepening has taken place in ASEAN countries in 1980s. Indonesia, Malaysia and Thailand experienced a doubling of the ratio of broad money to GNP, which is used here as a rough measure of financial deepening. Singapore has continued its process of financial deepening. Again, the only exception in this impressive performance of ASEAN countries is the Philippines. A liquidity crisis struck the Philippine economy in 1981, followed by a severe balance of payments problem in the mid-1980s. These resulted in the collapse of several financial institutions, which practically shook the people's confidence in the banking system and led to capital flight.

Over the past three decades, ASEAN economies have undergone a process of structural transformation, shifting their dependence from agriculture to non-agricultural activities. The service sector has increasingly become an important productive sector in their economies. In 1989, the share of the service sector in the GDP of ASEAN countries ranged from 39 percent to 63 percent. Their contribution to employment in ASEAN countries has also been significant. Quibria (1989) underscores the importance of the service sector in economic development:

"The role of services in economic development is far from unilinear. In many cases, development of services is not a consequence but a cause of growth. For example, an efficient financial sector, an extensive transportation and telecommunication network and well-run public administration: all are preconditions of growth and development. So is a well-developed infrastructure of health and education services. Traditionally, the service sector has not been the subject of conscious comprehensive planning. As a consequence, a lack of planning may result in the initial underdevelopment of key services." (p. 1)

The experience of Singapore serves to demonstrate that the service sector itself can be a growth sector.

The quantity and quality of the products produced by the service sector of ASEAN countries, however, greatly vary among each other. In Singapore, technology-intensive services (e.g., banking and telematics) are quite significant, while in Indonesia, the Philippines and Thailand, there is a predominance of traditional, labor-intensive services (e.g., restaurants, retailing, etc.). Such diversity reflects the varying levels of economic development among ASEAN countries.

Trade in services has now become a subject of the new round of multilateral negotiations. The issue here is basically similar to the one that emerged in earlier round of negotiations on trade in goods, i.e., gradually dismantling barriers to trade in services in such a way that both developed and developing

economies can benefit. This is not going to be an easy undertaking. Firstly, trade in services has already been dominated by developed economies, and further opening up of this sector will certainly be met with strong resistance by developing economies. Secondly, the service sector is so heterogeneous and include areas that are considered politically sensitive. Notwithstanding these, there is a need to closely examine the issues on trade in services so that more enlightened multilateral negotiations can proceed.

This paper focuses on the financial sector. Interestingly, the pattern of net financial flows to ASEAN countries has significantly changed over the last thirteen years. Net private flows sharply fell after the explosion of the international debt crisis in 1982 (see Figure 1 and Table 2 for details). This has some implications on the operations of branches/agencies/representative offices of foreign banks in these countries. It is to be noted that they facilitated the flow of direct foreign investments into these countries and provide banking services to multinational corporations. They were also involved in packaging sovereign loans for ASEAN countries. After the international debt crisis, their activities in these two areas have been considerably reduced because of the slowdown in foreign investment flows and the unattractiveness of sovereign loans.

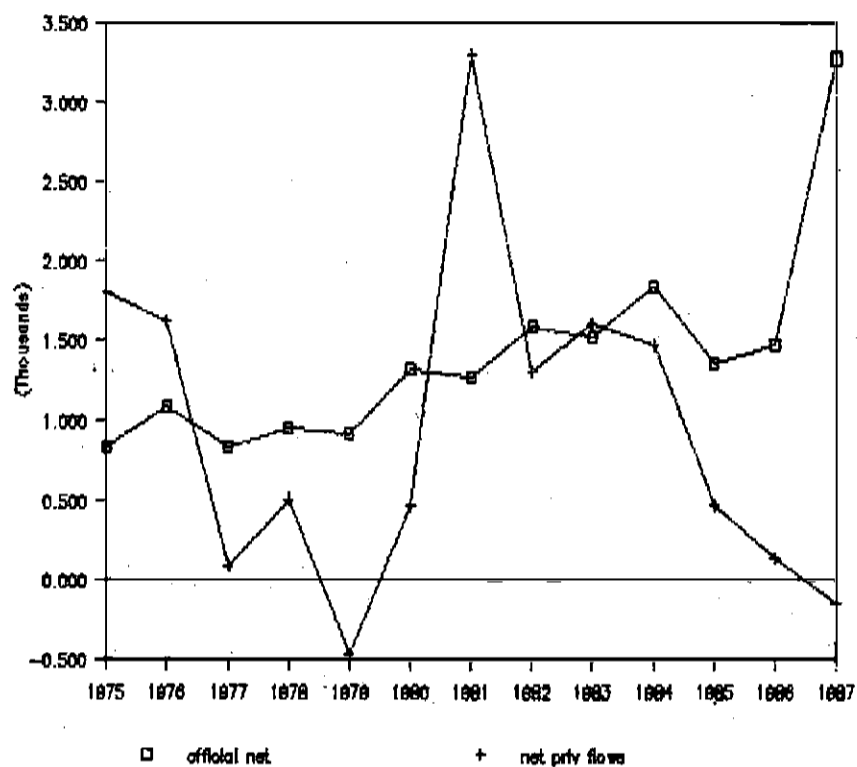
The banking sector is one of the sectors which will likely be included in the ongoing multilateral negotiations on trade in services.^{1/} It is envisaged that pivotal importance which is attributed to the sector and the existence of various different banking services would make the establishment of norms and regulations in the area a particularly complex matter. This paper analyzes, in the context of the ASEAN countries, various aspects which are deemed relevant to these negotiations, and explores the possibility of expanding trade in banking services as a means to achieving higher and sustainable economic growth of these countries. More specifically, it examines:

- 1) the scope of banking activities in the ASEAN region;
- 2) the structures of markets and competition;
- 3) the benefits and costs of a more liberal regime for international trade in banking services in the region;
- 4) the implications of the key concepts and principles discussed in the multilateral negotiations on trade in

^{1/} Banking services are a part of financial services. The latter, apart from banking services, include insurance, brokerage and services facilitating commodity and other goods trading (Iwata 1988).

Figure 1
NET FINANCIAL FLOWS TO ASEAN, 1975-1987
(In US\$ M)

INDONESIA		
	TOTAL OFFICIAL NET	NET PRIVATE FLOWS
1975	824	1803
1976	1083	1615
1977	837	71
1978	941	504
1979	907	-477
1980	1321	459
1981	1258	3310
1982	1579	1291
1983	1520	1597
1984	1839	1470
1985	1346	470
1986	1458	136
1987	3278	-155



MALAYSIA		
	TOTAL OFFICIAL NET	NET PRIVATE FLOWS
1975	164	151
1976	185	152
1977	194	47
1978	163	41
1979	213	505
1980	217	472
1981	258	733
1982	265	569
1983	359	1391
1984	454	965
1985	380	-147
1986	210	-226
1987	137	92

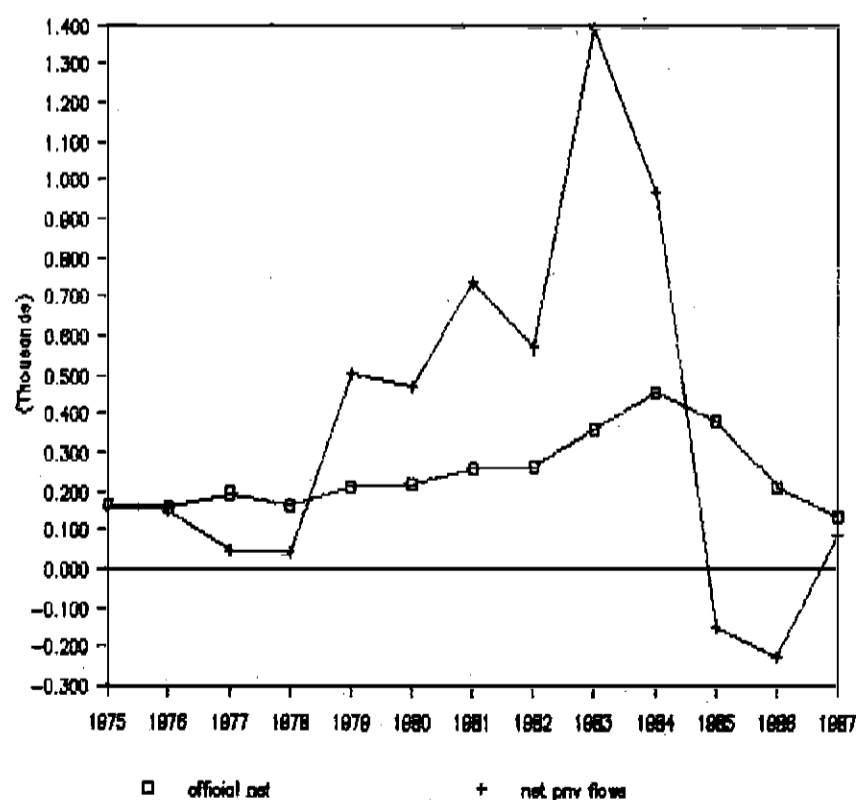
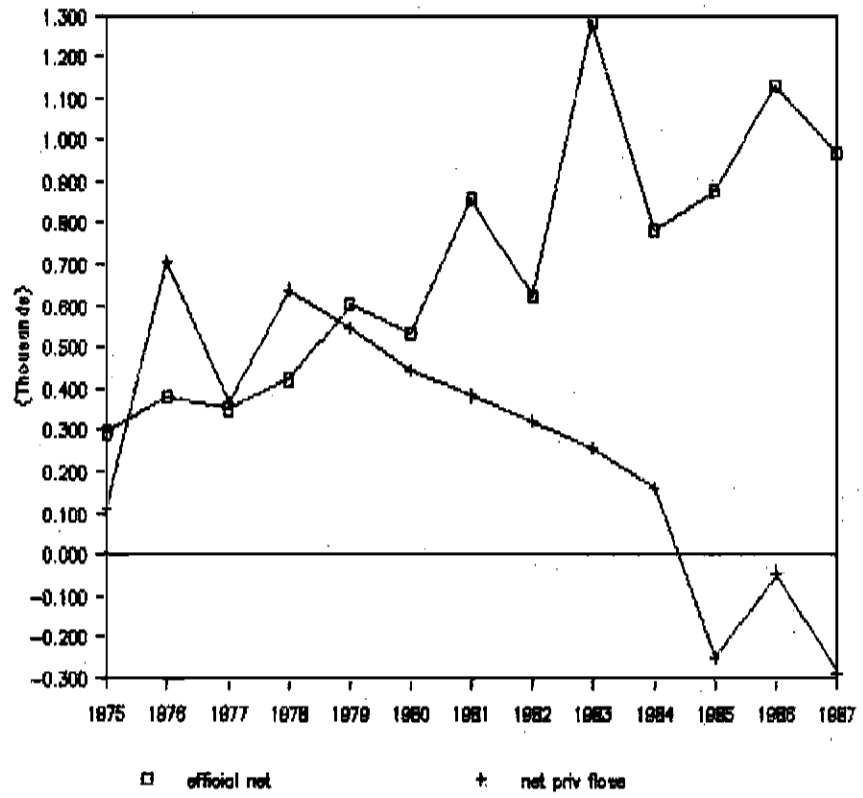


Figure 1 (cont'd.)

PHILIPPINES		
	TOTAL OFFICIAL NET	NET PRIVATE FLOWS
1975	293	108
1976	380	705
1977	351	365
1978	422	639
1979	605	548
1980	534	442
1981	860	383
1982	621	323
1983	1283	260
1984	784	162
1985	882	-248
1986	1132	-41
1987	970	-285



SINGAPORE		
	TOTAL OFFICIAL NET	NET PRIVATE FLOWS
1975	50	73
1976	35	136
1977	8	207
1978	103	262
1979	95	433
1980	43	709
1981	11	1374
1982	23	891
1983	-30	222
1984	87	1227
1985	-56	-211
1986	-189	79
1987	-220	947

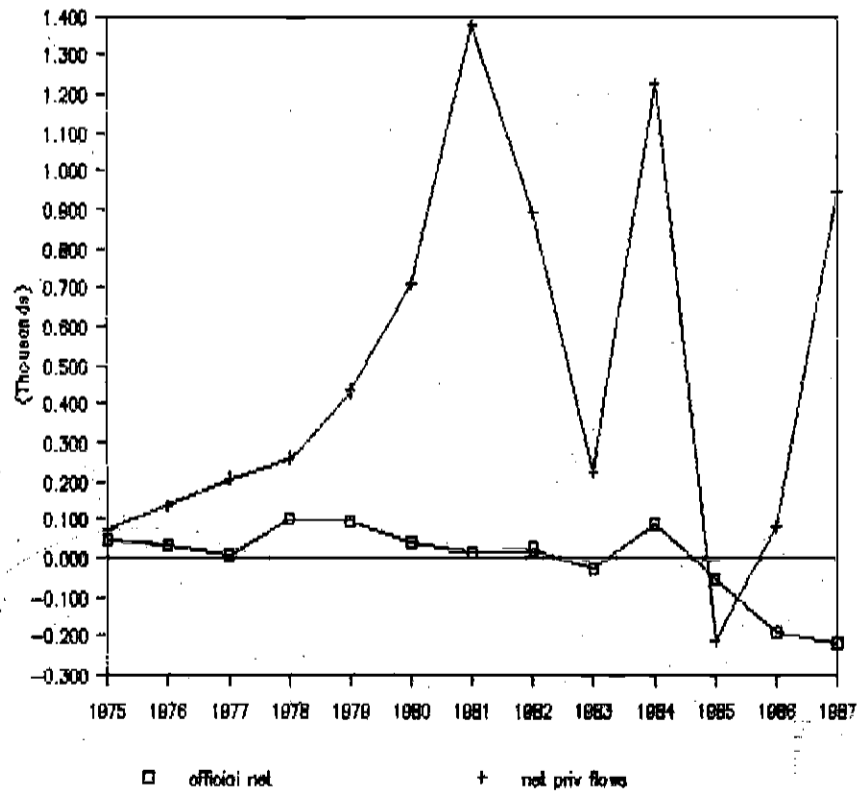
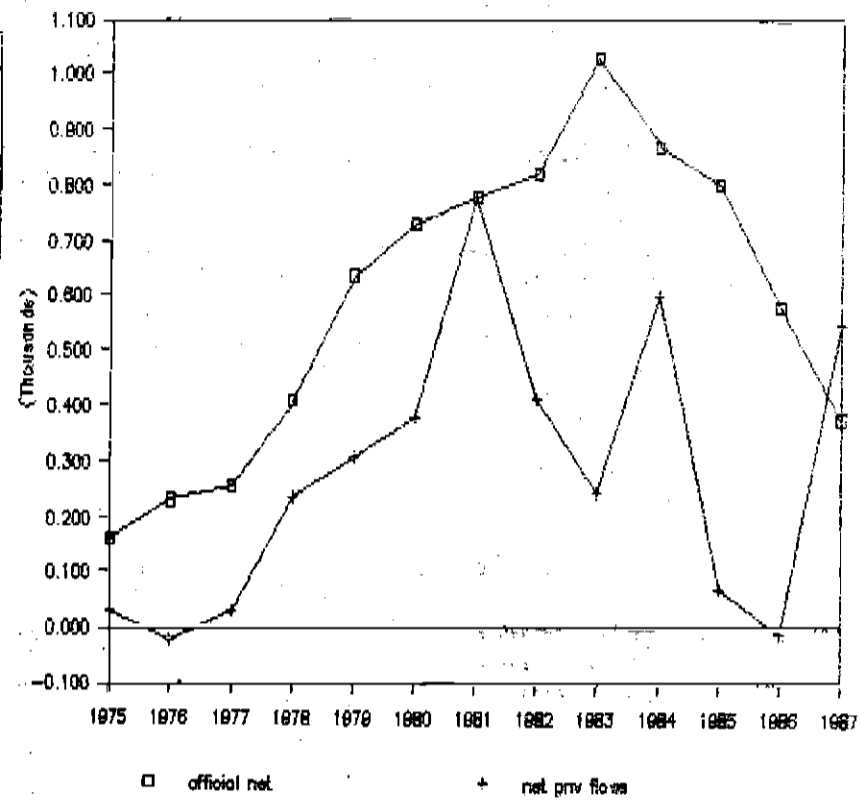


Figure 1 (cont'd.)

THAILAND		
	TOTAL OFFICIAL NET	NET PRIVATE FLOWS
1975	158	30
1976	230	-23
1977	254	31
1978	408	236
1979	638	308
1980	731	382
1981	782	781
1982	822	416
1983	1031	246
1984	870	602
1985	806	73
1986	583	-9
1987	378	547



Source: Table 2

Table 2
NET FINANCIAL FLOWS TO ASEM, 1970, 1975-1987
(In US\$ M)

	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
1. INDONESIA														
A. TOTAL OFFICIAL NET	413	824	1083	837	941	907	1321	1258	1579	1520	1839	1346	1458	3278
a. ODA Grants	110	153	142	161	192	281	296	324	315	316	327	338	379	480
b. ODA Loans	355	539	527	354	444	440	653	652	592	428	346	265	332	766
c. Other Official Flows, Net	-52	132	415	322	306	186	372	283	673	776	1166	743	747	2033
B. NET PRIVATE FLOWS	116	1803	1615	71	504	-477	459	3310	1291	1597	1470	470	136	-155
a. Direct Investments	145	1289	747	-67	418	-383	300	2584	537	303	494	-311	-539	-565
b. Portfolio Investments	12	10	302	16	113	-103	57	386	423	692	47	376	551	430
c. Export Credits	-42	504	566	123	-26	9	102	340	331	602	929	406	124	-20
2. MALAYSIA														
A. TOTAL OFFICIAL NET	44	164	155	194	163	213	217	258	265	359	454	300	210	137
a. ODA Grants	17	32	28	30	36	60	61	58	60	64	93	103	109	133
b. ODA Loans	9	66	34	42	44	65	75	86	75	113	234	127	3	230
c. Other Official Flows, Net	18	65	93	123	83	88	82	115	130	182	127	150	18	-226
B. NET PRIVATE FLOWS	45	151	152	47	41	505	472	733	569	1391	965	-147	-226	92
a. Direct Investments	38	73	133	134	-5	77	242	252	-429	234	227	140	-102	377
b. Portfolio Investments	0	-3	18	-124	56	65	22	110	671	928	625	-263	-41	-278
c. Export Credits	8	82	1	36	-10	363	209	371	326	229	113	-23	-82	-7
3. PHILIPPINES														
A. TOTAL OFFICIAL NET	146	293	380	351	422	605	534	860	621	1283	784	882	1132	970
a. ODA Grants	32	105	98	104	93	112	123	146	163	259	256	245	516	461
b. ODA Loans	14	75	89	79	156	156	180	230	170	170	141	242	440	314
c. Other Official Flows, Net	100	113	193	168	173	338	230	484	288	854	388	396	176	195
B. NET PRIVATE FLOWS	172	108	705	365	639	548	442	383	323	260	162	-248	-41	-285
a. Direct Investments	-1	117	154	116	144	330	128	115	126	-160	167	-250	60	85
b. Portfolio Investments	33	10	375	48	230	246	32	-32	132	334	-142	154	189	-169
c. Export Credits	140	-18	176	201	266	-28	282	301	65	95	137	-152	-209	-201
4. SINGAPORE														
A. TOTAL OFFICIAL NET	62	50	35	8	103	95	43	11	23	-30	87	-56	-189	-220
a. ODA Grants	15	7	8	7	12	13	19	23	23	21	28	20	37	32
b. ODA Loans	14	6	5	6	-5	-7	-5	-2	-2	-7	13	-4	-7	-8
c. Other Official Flows, Net	33	37	23	-5	96	89	29	-11	3	-45	46	-80	-218	-244
B. NET PRIVATE FLOWS	53	73	136	207	262	433	709	1374	891	222	1227	-211	79	947
a. Direct Investments	16	71	67	86	147	355	650	980	280	418	865	252	602	701
b. Portfolio Investments	1	27	86	100	127	-11	18	154	288	-99	339	-402	-511	371
c. Export Credits	36	-24	-17	21	-13	89	41	240	323	-97	23	-62	-12	-124
5. THAILAND														
A. TOTAL OFFICIAL NET	126	158	230	254	408	638	731	782	822	1031	870	806	583	378
a. ODA Grants	55	53	126	64	104	147	178	190	185	210	240	264	300	322
b. ODA Loans	20	37	44	68	157	246	240	217	204	222	226	217	180	184
c. Other Official Flows, Net	52	70	61	121	147	245	313	375	433	599	396	325	87	-129
B. NET PRIVATE FLOWS	73	30	-23	31	236	308	382	781	416	246	602	73	-9	547
a. Direct Investments	14	19	18	42	38	38	218	219	128	200	348	-98	-6	459
b. Portfolio Investments	10	0	-9	-9	125	205	35	159	79	112	306	240	133	117
c. Export Credits	49	12	-33	-3	72	-65	130	404	209	-66	-52	-70	-136	-29

Source: Lee, Jungsoo and I.P. David. "Changing Pattern of Financial Flows to Asian and Pacific Developing Countries." ADB Statistical Report Series No. 11 (March 1989).

services to the banking sector in the ASEAN countries;
and

- 5) the possibility of increasing competitiveness of banks in ASEAN countries and increasing their share of international trade in banking services including through regional cooperation and the Uruguay Round of trade negotiations on services.

A section will be devoted to each of these specific objectives.

II. SCOPE OF BANKING ACTIVITIES IN THE ASEAN REGION

Although still underdeveloped relative to the financial systems of the OECD countries, the financial systems of ASEAN countries have already achieved a certain degree of sophistication. This may be gathered from the great number and variety of financial institutions that have emerged in ASEAN countries in the last two decades, the multitude of financial services being offered, and the financial instruments that have been created. These developments could be attributed to several factors. One is that ASEAN countries started the process of liberalizing their financial system in the 1970s, albeit at varying degree and speed. That process is still being pursued at present. The response of the financial systems in ASEAN countries to liberalization has generally been positive. Another is the technological advancement in banking that facilitated the improvement of existing services and resulted in the introduction of new services at a much reduced cost to both banks and customers. The introduction of automated teller machines is one example. Computerization has also allowed banks to offer savings deposit instruments whose interest is compounded daily. Interestingly, this is one area where banking technology developed in advanced economies can be easily copied by less developed countries at least cost, especially if certain infrastructures, such as electricity and telecommunications, are readily available, and if the population are generally well-educated. Still another factor is the generally impressive economic growth of ASEAN economies which resulted in the changing demand for financial services by the corporate sector, individuals, and institutional investors. This has led to the emergence of new types of financial institutions, like the merchant banks in Malaysia and Singapore, the offshore banks in the Philippines and Singapore, among others. A wide range of instruments has also been introduced by existing and newly-created financial institutions. Examples of these instruments are bankers acceptances, negotiable certificate of deposits, and other deposit substitutes. Banks have recently expanded their fee-based services or off-balance sheet activities. This is most evident in Singapore, Malaysia, the Philippines and Thailand.

It is to be noted that the monetary authorities and governments in ASEAN countries have played a great role in developing their respective financial infrastructure. In the main, they determine and regulate what kinds of activities a financial institution, whether owned by the government or the private sector, can do. Each type of financial institution is therefore covered by specific set of regulations. For prudential reasons, the kinds of activities allowed for different types of financial institutions are associated with different minimum capital requirements. Except for Singapore, governments in ASEAN countries force their banks to perform developmental functions. Thus, loan portfolio requirements, that is requiring banks to lend a certain amount of their total loanable funds to specific sector, are not uncommon in the region.

In general, financial institutions in ASEAN countries may be distinguished by the types of liabilities and assets they are legally allowed to hold. Banking institutions are allowed to mobilize traditional deposits (such as demand, savings and time deposits), whereas nonbank financial institutions are not. Among banking institutions, some are restricted to mobilize only certain types of deposits distinguished by degree of liquidity, maturity, size, etc. The nonbanking institutions are fairly numerous and heterogeneous even within the same ASEAN country. Still, in terms of assets, they are small relative to the banking institutions. However, they have shown to be innovative and have put up competition with banks.

In the past, competition was encouraged, but this was limited only to financial institutions belonging to the same category. This resulted in the segmentation of the financial markets. At present, there is a move towards universal banking. This requires the reduction or blurring of distinction among different types of financial institutions. Singapore is way ahead in this new approach, followed by Malaysia and the Philippines. The ongoing financial reforms in Indonesia and Thailand also suggest such trend. ^{2/}

Table 3 shows banking density ratios in ASEAN countries. It roughly indicates the extent of access of the population of the ASEAN countries to their respective banking systems. The ratio tends to vary inversely with the level of development of the countries concerned; that is, population in more developed ASEAN countries has better access to banking services compared to those

^{2/}

In Indonesia, the deregulation packages were incorporated in PACTO 27 (October 1988), PAKDES II (December 1988), PAKMAR (March 1989) and PAKJAN (January 1990).

Table 3
BANKING DENSITY IN ASEAN COUNTRIES, 1988

	INDONESIA	MALAYSIA	PHILIPPINES	SINGAPORE	THAILAND
Population (in million)	175.22	16.90	58.80	2.60	54.55
No. of banking offices	7,423	1,548	3,562	729	2,655
Banking density	23,605	10,917	16,507	3,566	20,546

Note: This includes only offices of the banking system. For Indonesia, the number of banking offices is as of March 1988.

Sources: 1) Asian Development Bank. Asian Development Outlook 1990 (Manila: ADB, 1990).
 2) Erquiaga, Philip. "Improving Domestic Resource Mobilization Through Financial Development - Indonesia." ADB Economic Staff Paper No. 40.
 3) Lin See-Yan et al. "Money Market in Malaysia." Unpublished (1990).
 4) Central Bank of the Philippines. 1988 Fact Book: Philippine Financial System (Manila: Central Bank of the Philippines, 1988).
 5) Tyabji, Amina. "Financial Reform in ASEAN." Unpublished (1989).
 6) Bank of Thailand. Financial Institutions and Market in Thailand (December 1989).

in less developed ones. ^{3/} Only Singapore can compare with more developed economies in this area. It is to be noted that most banks and their branches are concentrated in urban areas, leaving the countryside with very little access to banking services. This problem is most acute in Indonesia, the Philippines and Thailand. The numerous and small banks that have been established in the countryside have merely served as conduits of government funds. Hence, they do not truly provide banking services to rural people.

After giving an overview of the banking activities of ASEAN countries, we now briefly describe the scope of banking activities in each of the ASEAN member countries. Less emphasis will be given to activities of nonbanking institutions.

A. INDONESIA

The financial system in Indonesia consists of deposit money banks, rural financial institutions, savings banks, and different types of nonbank financial institutions (see Table 4). ^{4/} In terms of assets, deposit money banks dominate the financial system.

Deposit money banks may be classified according to ownership. There are five banks that are wholly owned by the Indonesian government. Arndt (1987) succinctly describes their activities in the following manner:

"Except in foreign exchange business where the foreign banks are important, the state commercial banks, favoured by a wide variety of privileges, from tax exemptions, subsidies and rediscount facilities to a virtual monopoly of government and other public sector banking business, provide the bulk of banking facilities in their branches all over the country. They hold the major part of demand and time deposits, manage customers' accounts, organize transfers of funds domestically and internationally, cooperate in clearing of inter-bank debts, and conduct the whole range of loan business, from short-term trade credit and personal loans to medium and longer-term loans to the state and private corporate sector." (p. 306)

^{3/} In 1982, the density ratio for Australia, New Zealand, United States, and Canada ranged from 3,000 to 6,000 as compared with Singapore's 11,000. But this hides the fact that Singapore also plays as a leading financial center in the region.

^{4/} As of 14 August 1990, the exchange rate was Rp1845.02 per US\$1.

Table 4
FINANCIAL INSTITUTIONS IN INDONESIA
SEPTEMBER 1989

Type of Financial Institution	Number of Head Offices	Total Assets (Rp.bil.)	%
Deposit Money Banks (DMBs):	141	85,740	86.3
State Banks	5	51,450	51.8
Joint Venture 1/	12	-	-
Foreign Bank Branches	10	4,626	4.7
Development Banks	29	6,384	6.4
BAPINDO	1	3,886	3.9
Regional Development Banks	27	2,498	2.5
Private	1	-	-
Private Banks	85	23,469	23.6
Nonforeign Exchange	64	7,510	7.6
Foreign Exchange	21	15,959	16.1
Rural Financial Institutions:	7,713	579	0.6
Existing before PAKTO	7,236	55	0.1
Established after PAKTO	477	524	0.5
Savings Banks:			
State Savings Bank (BTN)	1	2,531	2.5
Private Savings Banks	4	-	-
Pawnshops (State-owned) 2/	1	152	0.2
State Securities & Investment Fund Co. (DANAREKSA)	1	298	0.3
Nonbank Financial Institutions:	13	3,564	3.6
Development Finance Institutions	3	837	0.8
Investment Finance Institutions	9	2,413	2.4
Housing Finance (Papan Sejahtera)	1	314	0.3
Insurance:	130	3,906	3.9
Life	30	799	0.8
Loss	77	844	0.9
Social Insurance 3/	5	1,930	1.9
Reinsurers	4	333	0.3
Adjusters	14	-	-

Table 4 (cont'd.)

Type of Financial Institution	Number of Head Offices	Total Assets (Rp.bil.)	%
Pension Funds 4/	130	1,329	1.3
TASPEN	1	1,105	1.1
Others	129	224	0.2
Securities Companies	7	-	-
Brokers/Dealers	129	-	-
Nondeposit Financial Institutions:	154	-	-
Leasing Companies	101	1,195	1.2
Factoring	14	-	-
Venture Capital	7	-	-
Credit Card	11	-	-
Consumer Finance	21	-	-
T O T A L	8,424	99,294	100.0
	=====	=====	=====

Notes:

- 1/ These banks are joint-ventures between Indonesian and foreign banks.
- 2/ There is one Pawnshop office with 487 branch offices.
- 3/ Includes ASABRI, the military employees social insurance fund.
- 4/ Excludes unknown member of pension funds that are not registered with the Ministry of Finance.

Source: Cole, David C. and Betty F. Slade. "Development of Money Markets in Indonesia." Unpublished (1990).

In addition to what Arndt had mentioned, state commercial banks are also allowed to issue three types of certificates of deposits: discount, monthly interest payment, and balloon interest and principal payment. In the asset side, they were supposed to specialize in lending to a few sectors, but over the years, they have progressively overlapped each other so that the distinctions between them have been reduced to a minimum.

Like state banks, private national commercial banks raise funds by issuing demand and time deposit liabilities. Although permitted to lend at any maturity, they tend to concentrate in the provision of short-term loans (usually 6 months or less). This is not unusual among private commercial banks in ASEAN countries. Private national commercial banks used to be classified into foreign exchange and nonforeign exchange banks. But under the October 1988 deregulation package (called PACTO 27), nonforeign exchange banks may deal in foreign exchange if classified "sound" in 20 of last 24 months and their total assets are greater than Rp100 B.

Foreign banks have a wider array of sources of funds, such as demand, savings and time deposits as well as borrowing from the international markets. They may also engage in currency swaps with Bank Indonesia, the central bank of Indonesia, or borrow in the interbank market for rupiah funds. Foreign banks' loans have been concentrated in the overdrafts and short-term facilities. Any investment loans they want to make need special permission from Bank Indonesia. Most of the multinational companies in Indonesia prefer to bank with them. Together with more than 50 representative offices of foreign banks in Indonesia, foreign banks had been involved in one way or another in the negotiation of foreign loans and foreign direct investment.

Development banks consist of one state-owned bank, 27 development banks which are either directly owned by local authorities or jointly owned by local authorities and private sector, and one privately-owned bank. These banks concentrate in investment loans, and medium- and long-term loans. The state-owned development bank raises funds by accepting demand and time deposits, and borrowing from Bank Indonesia, the government, and foreign long-term sources of funds. The local development banks are allowed to issue time and savings deposits. They may also have refinancing arrangement with the state-owned development bank.

The savings banks include one state-owned bank and four privately owned banks. The state-owned savings bank mobilizes deposits through the post office network. These savings are used to meet the credit requirements of low-income sectors.

The Indonesian government has equity participation in several nonbank financial intermediaries. Interestingly, foreign

institutions have minority participation in almost all of the 12 nonbank financial intermediaries. Cole and Slade (1990) describe the activities of nonbank financial intermediaries as follows:

"they deal in foreign exchange, commercial paper, long-term stocks and bonds, SBIs and SBPUs, and CDs, as well as in many banking operations. They serve as 'agents' for State-owned bank purchases of SBIs and as "market makers" in the SBI market." (p. 25). ^{5/}

B. MALAYSIA

Table 5 shows the financial system of Malaysia. In terms of assets, the banking institutions have dominated the system. ^{6/} The banking system consists of commercial banks, finance companies, merchant banks, discount houses and a specialized commercial bank that offers commercial banking services based on Islamic principles. Participation of branches of foreign banks in the Malaysian banking system is quite substantial.

Commercial banks in Malaysia carry the usual commercial banking functions in both the liability and the asset sides. They are the only ones licensed as full trading and cheque-paying banks (Lin et al. 1990). They are also allowed to deal in foreign exchange and to offer a variety of fee-based services. They may invest in shares of public and private companies up to 50 percent of their capital base. The most important restriction in their liability side is that they are not allowed to accept deposits of less than one-month maturity.

Finance companies cater to the medium- and long-term markets. They are allowed to accept savings and fixed deposits of three-month maturity or more but not demand deposits. They are not permitted to deal in foreign exchange nor grant loans in the form of overdrafts. Their loans are mostly of long-term maturity.

Merchant banks operate in both the capital and money markets. In the capital markets, they provide underwriting facilities, corporate financing, financial investment, management advice and portfolio investment management. In the money markets, they engage in the trading of money market instruments.

^{5/} SBI stands for Sertificat Bank Indonesia, a discount bill, which is a liability of Bank Indonesia. SBPU stands for Surat Berharga Pasar Uang, which is another instrument used in the open market operations of Bank Indonesia.

^{6/} As of 14 August 1990, the exchange rate was M\$2.70 per US\$1.

Table 5
THE FINANCIAL SYSTEM IN MALAYSIA, 1988

Type of Institutions	Number of Head Offices	Assets (M\$ M)	%
I. BANKING INSTITUTIONS			
Commercial Banks	38	93,021	31.87
Domestic	22	69,500	23.81
Foreign	16	23,521	8.06
Islamic Bank	1	1,429	0.49
Finance	47	24,283	8.32
Merchant Banks	12	7,026	2.41
Discount Houses	7	2,211	0.76
TOTAL	143	220,991	75.71
II. NONBANK FINANCIAL INTERMEDIARIES			
Development Finance Institutions	7	3,500	1.20
Savings Institutions	14	2,487	0.85
Provident Pension Funds 1/	10	47,490	16.27
Insurance Companies	105	7,011	2.40
Other Financial Intermediaries 1/	7	10,401	3.56
TOTAL	143	70,889	24.29
G R A N D T O T A L	286	291,880	100.00

1/ Only six large ones are included.

Source: Lin, See-Yan *et al.* "Regional Research Project: Study of Money Markets in Asia." Unpublished (1990).

Merchant banks are allowed to accept only large term deposits from financial institutions (not less than M\$250,000 per deposit), corporations (not less than M\$1 M per deposit), and foreign currency deposits from nonresidents (not less than M\$250,000 per deposit).

Discount houses operate mainly in the money markets. They are permitted to accept funds at call or short-term deposits of up to three months with a minimum denomination of M\$50,000 from financial institutions, corporations, Federal, State, and local governments. Thus, they provide those with temporary surplus funds with an alternative investment outlet. The funds they raised are mainly invested in government securities. They are not allowed to lend to the public.

C. THE PHILIPPINES

The structure of the Philippine financial system is not entirely different from the rest of ASEAN countries. The financial institutions may be grouped into banking and non-banking financial institutions, with the former dominating the system in terms of assets (see Table 6). ^{7/} The Government's presence in both categories is substantial. Foreign participation in the banking system is also significant. Like the rest of the ASEAN countries, the Philippines is also moving towards universal banking and the reduction in the differentiation among different types of bank categories. Table 7 gives a summary of the authorized activities of various bank categories in the Philippines. Leasing is the only activity that is absolutely not allowed to universal and ordinary commercial banks. On the other hand, other types of banks may now obtain authority to perform functions that used to be reserved only to commercial banks provided they meet certain criteria, like minimum capital requirement.

The Philippines has an offshore banking system which is patterned after Singapore's. There were 21 offshore banking units (OBUs) as of December 1988 with total assets of US\$2.7 B. This does not compare with those in Singapore. OBUs may use any currency, except domestic currency, in their transactions. Thus, they do not have swap facilities. They cannot accept deposits in foreign currency less than US\$50,000. The purpose of establishing OBUs was to increase local residents' access to foreign currency funds. This may have been attained as suggested by the data in Table 8, which shows that most of the funds of OBUs were lent onshore.

Recently, the Philippine commercial banks have been very active in their off-balance sheet activities. These are

^{7/} As of 14 August 1990, the exchange rate was P24.20 per US\$1.

Table 6
THE PHILIPPINE FINANCIAL SYSTEM
(As of December 31, 1988)

	Number of Head Offices	Amount (₱ B)	%
BANKING SYSTEM	982	360.1	72.0
	===	=====	=====
Commercial Banks	29	299.3	59.8
-Private	24	224.6	44.9
-Government	1	38.8	7.8
-Foreign	4	35.9	7.2
Thrift Banks	110	24.9	5.0
-Savings & mortgage banks	8	14.2	2.8
-Private development banks	41	6.7	1.3
-Stock savings & loan associations	61	4.0	0.8
Rural Banks	840	10.7	2.1
Specialized Government Banks	3	25.2	5.0
NONBANK FINANCIAL INTERMEDIARIES	2,766	140.2	28.0
	=====	=====	=====
Insurance Companies	135	98.3	19.6
-Government	4	68.6	13.7
-Private	131	29.7	5.9
Investment Institutions	233	21.4	4.3
-Financing companies	143	7.4	1.5
-Investment companies	75	5.6	1.1
-Investment houses	15	8.4	1.7
Trust Operations (fund managers)	12	1.8	0.4
Other Financial Intermediaries	2,386	18.7	3.7
T O T A L	3,758	500.3	100.0
	=====	=====	=====

Sources: Philippine Financial Fact Book (1988);
Insurance Commission (for data on insurance
companies in 1988); and
Government Corporate Monitoring and Coordinating
Committee, for the assets of Social Security System and
Government Service Insurance System in 1988.

Table 7
 AUTHORIZED ACTIVITIES OF VARIOUS BANK CATEGORIES IN THE PHILIPPINES
 BASED ON THE AMENDED BANKING LAWS

Authorized Activities	(1) Expanded Commercial Banks (Unibank)	(2) Commercial Banks (KBs)		(3) Thrift Banks			Rural Banks
		Domestic	Foreign	Savings & Mortgage Banks	Private Dev. Banks	Savings and Loan Association	
A. Commercial Banking Services							
1. Accept deposits	1	1	1	1	1	1	1
2. Issue LCs and accept drafts	1	1	1 a/	1 a/	1 a/	1	1
3. Discounting of promissory notes and commercial papers	1	1	1	1	1	1	1
4. Foreign exchange transactions	1	1	1	11	11	11	1
5. Lend money against security	1	1	1	1	1	1	1
B. Nationwide Branching Operations	1	1	1	1	1	1	1
C. Equity Investments in Allied Undertakings	11	11	11	11	11	11	11
D. Equity Investments in Non-allied Undertakings	1	1	1	1	1	1	1
E. Trust Operation	11	11	11	11	11	11	11
F. Issue Real Estate and Chattel Mortgage, Bonds Buy and Sell These for its Own Account, Accept/Receive in Payment or as Amortization of Loan	1	1	1	1	1	1	1
G. Direct Borrowing with Central Bank	1	1	1	1	1	1	1

Table 7 (cont'd)

Authorized Activities	(1)	(2)		(3)			Rural Banks
	Expanded Commercial Banks (Unibank)	Commercial Banks (KBs)		Thrift Banks			
		Domestic	Foreign	Savings & Mortgage Banks	Private Dev. Banks	Savings and Loan Association	
H. Activities of an Investment House							
1. Securities underwriting	1	‡	‡	‡	‡	‡	‡
2. Syndication activities	1	1	1	1	1	1	1
3. Business development and project implementation	1	1	1	1	1	1	1
4. Financial consultancy and investment	1	1	1	1	1	1	1
5. Mergers and consolidation	1	1	1	1	1	1	1
6. Research and studies	1	1	1	1	1	1	1
7. Lease real and/or personal properties	‡	‡	‡	‡	‡	‡	‡
I. Money Market Operation	1 b/	1 b/	1 b/	‡ 1/	‡ b/	‡ b/	‡ b/

1 - Authorized activities
 11 - Authorized but subjected to monetary board approval
 ‡ - Not authorized/prohibited

a/ Limited only to domestic LCs and drafts.

b/ The lending side may be done by all banks without
 The borrowing side (quasi-banking) may be exercised
 CB approval for all banks.

approval.
 prior

Source: Lamberte, Mario B. "The Financial System of the
 Unpublished (July 1998).

Operations and Problems."

Table 8
PHILIPPINE OFFSHORE BANKING SYSTEM
STATEMENT OF ASSETS AND LIABILITIES, SEPTEMBER 1989

Items	US\$ (Million)
ASSETS	
Notes and Coins on Hand	0
Due from Banks	1,506
- Outside the Philippines	359
- In the Philippines	1,147
Loans and Discounts to Customers	
Other than Banks	1,096
- Nonresidents	115
- Residents	981
Public Sector	481
Private Sector	500
Bills Discounted/Purchased	1
- Nonresidents	0
- Residents	1
Investment in Bonds and Other Securities	28
- Nonresidents	20
- Residents	8
All Other Assets	86
- Interest Receivable	40
Nonresidents	8
Residents	32
- Other Assets in the Philippines	45
- Other Assets Outside the Philippines	1
Total Assets	2,717
Less: Allowance for Probable Losses	20
Total Assets After Allowance for Losses	2,697
LIABILITIES	
Deposit of Nonresidents Other than Banks	40
Due to Banks	2,554
Outside the Philippines	2,205
In the Philippines	349
Other Liabilities	103
Interest Payable	37
Nonresidents	33
Residents	4
In the Philippines	31
Outside the Philippines	35
Total Liabilities	2,697

Source: Foreign Exchange Regulations Department,
Central Bank of the Philippines.

activities that generate income for banks without expanding the asset portion of their standard balance sheet. Table 9 shows the phenomenal growth of these activities among universal and commercial banks.

D. SINGAPORE

Singapore has the largest and most sophisticated financial system in the ASEAN region. It is considered as the fifth largest foreign exchange center in the world today (Ariff et al. 1990). Its financial system consists of commercial banks, merchant banks, finance companies, national savings bank, discount houses and international money brokers (see Tables 10 and 11). ^{8/} Given its highly open policy and liberal exchange rate policy, the number of foreign banks increased tremendously and has made a very significant contribution to its financial system. All commercial banks may obtain from the monetary authorities an authority to transact in the Asian Dollar Market. They are, however, distinguished by the extent of their domestic banking business permitted by the monetary authorities. Both foreign and local full license banks are authorized to engage in the entire range of domestic banking business. Restricted license banks can perform domestic banking functions, but they are not permitted to accept savings and fixed deposits below S\$250,000 from the nonbank public. The offshore license banks are authorized to engage in any transactions with nonresidents except that they cannot accept deposits in any currency or fixed deposits below S\$250,000. Also, they are not allowed to accept any interest bearing deposits from resident nonbank customers nor lend to them in excess of S\$50 M (Tyabji 1989). This has made offshore banks in Singapore regionally and internationally oriented. ^{9/} This is supported by the data in Table 12. The shares of the items "amount due to and from banks" are significantly high in the case of commercial banks with Asian Currency Units.

Merchant banks in Singapore are similar in nature to the merchant banks of Malaysia. They are active in both the money and capital markets. They are not permitted to accept deposits from the public. But they may source funds from the bank and may participate in the foreign exchange market with the approval of the monetary authorities. The data in Table 11 suggest that merchant banks in Singapore are significantly active participants in the Asian Dollar Market.

^{8/} Discount houses were discontinued in 1986. As of 14 August 1990, the exchange rate was S\$1.80 per US\$1.

^{9/} In contrast, the Philippine offshore banks have been made domestically oriented.

Table 9
 TRUST AND FUNDS MANAGEMENT ASSETS
 OF COMMERCIAL BANKS IN THE PHILIPPINES
 (In ₱M)

Year	Trust Assets	Funds Management Assets	Total
1984	11,260	6,837	18,097
1985	15,453	9,484	26,937
1986	22,457	11,395	33,852
1987	21,602	16,657	38,259
1988	27,575	23,624	51,199
Ave. Growth Rate (%)	26.7	36.7	30.4

Source: Central Bank of the Philippines.

Table 10
MONEY MARKET INSTITUTIONS IN SINGAPORE, 1988

	Number of Head Offices
Commercial Banks	
Local Full License Banks	13
Foreign	121
Full License Banks	22
Restricted Banks	14
Offshore Banks	85
Asian Currency Units (ACUs)	187
Merchant Banks	63
Finance Companies	31
National Saving Bank (POSB)	1
Discount Houses	-
International Money Brokers	8

Source: Ariff, M., B. Kapur, and A. Tyabji.
"Money Market Study: Singapore."
Unpublished (1990).

Table 11
ASSETS OF MONEY MARKET INSTITUTIONS
IN SINGAPORE, 1988

BANK TYPE	S\$ M
Commercial Banks	
Domestic Operations	96,441
Domestic and Offshore	586,215
Merchant Banks	
Domestic Operations 1/	8,274
Domestic and Offshore	36,942
Finance Companies	8,479
Discount Houses 2/	2,458
National Savings Bank 3/	12,262
T O T A L	646,338

1/ Figures do not reflect corporate financial advisory services, underwriting and operations in the gold market.

2/ Discount houses were discontinued in 1986.

3/ Total depositors' balances.

Source: Ariff, M., B.K. Kapur, and A. Tyabji.
"Money Markets Study: Singapore."
Unpublished (1990).

Table 12
SINGAPORE COMMERCIAL BANKS: ASSETS AND LIABILITIES, 1988
(In S\$ M)

Items	Excluding ACUs		Including ACUs	
	Amount	%	Amount	%
Assets				
Cash on Hand	568	0.6	598	0.1
Balances with MAS	2,371	2.5	2,371	0.4
Amount Due from Banks	38,148	39.6	388,953	65.0
Money at Call with Discount Houses	-	-	-	-
S\$ NCDs Held	146	0.2	2,660	0.5
Investments in Securities and Equities	9,853	9.4	25,616	4.4
Loans and Advances (Including Bills)	41,849	43.4	168,293	27.3
Other Assets	4,387	4.5	13,731	2.3
Total Assets	96,441	100.0	586,215	100.0
Liabilities				
Capital and Reserves	6,768	7.0	8,858	1.4
Deposits of Nonbank Customers	42,475	44.0	125,469	21.4
S\$ NCDs Issued 1/	993	1.0	5,186	0.9
Amount Due to Banks	39,328	40.8	427,544	72.9
Other Liabilities	6,886	7.1	28,037	3.4
Total Liabilities	96,441	100.0	586,215	100.0

1/ Singapore dollar negotiable certificates of deposits (S\$ NCDs) were first issued by banks in May 1975.

Source: N. Ariff, B.K. Kapur, and A. Tyabji. "Money Markets Study: Singapore." Unpublished (1998)

Finance companies in Singapore have limited banking functions. Although they are permitted to accept savings and time deposits and grant loans to bank and nonbank entities, they do not have current account facilities. Also, they cannot deal in gold and foreign currency.

The Post Office Savings Bank (POSB), a government-owned savings institution, is very much active in the deposit market. It has 137 branches. It has current accounts and savings deposit facilities. It is not, however, permitted to accept corporate deposits, finance foreign trade and engage in foreign exchange transactions. It may lend to banking and nonbanking institutions. Lately, it has become a significant player in the money market of Singapore.

E. THAILAND

Table 13 shows the financial system in Thailand. Like other ASEAN countries, the banking system has dominated the financial system in terms of assets. ^{10/} Its banking system is composed of 30 commercial banks, of which 16 are domestic and 14 are branches of foreign banks, and three specialized government-owned banks. Of the 16 domestic banks, only one bank (the second largest bank) is owned by the Thai government.

The activities of the six types of financial institutions in Thailand are summarized in Table 14. Commercial banks mobilize funds by accepting demand, savings, and time deposits, and by borrowing from domestic and foreign sources. Lending in the form of overdrafts used to be the most popular activity among commercial banks in Thailand. ^{11/} In the recent past, however, loans and bills discounted have increasingly become important activities of commercial banks. Recently, commercial banks have been permitted to deal in foreign exchange and undertake several fee-based activities, such as loan syndication, consultancy service for merger and acquisition, issuing credit cards, issuing L/Cs, bill collecting for government agencies, etc. Local corporate underwriting, stock broking, leasing, trust business, and management of provident funds are not allowed to them. The share of income from fee-based services in the total income of commercial banks has significantly increased from 5.6 percent in 1983 to 10 percent in 1987. Thailand still maintains ceilings on interest rate on loans and deposits.

We must underscore at this point the increasing internationalization of banking in the ASEAN region. It comes in two

^{10/} As of 14 August 1990, the exchange rate was Baht25.57 per US\$1.

^{11/} Note that overdrafts are not allowed anymore in the Philippines.

Table 13
FINANCIAL SYSTEM IN THAILAND, 1988

Type of Financial Institutions	Number of Head Offices	Assets (Million Bahts)	%
I. BANKING SYSTEM			
Commercial Banks	30	1,596,780	76.68
Domestic	16	1,513,795	72.70
Foreign	14	82,985	3.99
Government Savings Bank	1	124,273	5.97
Government Housing Bank	1	19,524	0.94
Bank for Agriculture and Agricultural Cooperatives	1	37,326	1.79
	--	-----	-----
TOTAL	63	1,777,903	85.38
	==	=====	=====
II. Nonbank Financial Intermediaries			
Finance and Securities Companies	94	195,687	9.40
Credit Foncier Companies	19	3,918	0.19
Agricultural Cooperatives	1,251	13,959	0.67
Savings Cooperatives	785	30,898	1.48
Life Insurance Companies	12	29,257	1.41
Pawnshops	338	6,505	0.31
Industrial Finance Corporation of Thailand	1	24,105	1.16
Small Industries Finance Office	1	78	0.00
	----	-----	-----
TOTAL	2,501	304,407	14.62
	=====	=====	=====
G R A N D T O T A L			
	2,564	2,082,310	100.00

Source: Bank of Thailand. "Financial Institutions and Market in Thailand." Unpublished (December 1989).

Table 14
BRIEF PROFILE OF ACTIVITIES OF SIX TYPES OF FINANCIAL INSTITUTIONS IN THAILAND
(As of 1984)

INSTITUTIONS	ACTIVITY	SUPERVISING INSTITUTION
1. (a) Commercial Banks	(1) Mobilize funds by taking deposits from the public (2) Lending in the forms of loan, overdraft and bill discounting (3) Investing in securities	Bank of Thailand
(b) Gov't. Savings Bank	(1) Mobilize funds by taking deposits from the public (2) Investing in government securities (3) Lending to the public	Bank of Thailand
(c) Gov't. Housing Bank	(1) Mobilize funds by taking deposits from the public (2) Lending to the public for housing purposes	Ministry of Finance
(d) Bank for Agriculture and Agricultural Cooperatives (BAAC)	(1) Taking deposits from the public (2) Lending to farmers and agricultural cooperatives	Ministry of Finance
2. (a) Finance and Securities Companies	(1) Issuing promissory notes (2) Purchasing promissory notes (3) Investing in securities	Bank of Thailand
(b) Credit Foncier Co.	(1) Mobilize medium-term funds (not less than 3 years) from the public by issuing promissory notes at minimum amount of Baht 1,000 per note (2) Lending for housing purposes	Ministry of Finance
3. (a) Agricultural Coop.	(1) Main sources of funds are borrowings from BAAC and members' subscriptions to capital account (2) Lending directly to their members	Ministry of Agriculture and Agricultural Cooperatives
(b) Savings Cooperatives	(1) Main sources of funds are paid-up share capital and members' savings (2) Lending short-term and long-term funds to members	Ministry of Agriculture and Agricultural Cooperatives

Table 14 (cont'd.)

INSTITUTIONS	ACTIVITY	SUPERVISING INSTITUTION
4. Life Insurance Companies	(1) Selling life insurance policies to the public (2) Lending and investing in securities	Ministry of Commerce
5. Pawnshops	(1) Main sources of funds are their own savings and borrowings from financial institutions (2) Lending money against a variety of articles, jewelry, gold, machine, electrical appliances, etc.	Ministry of Interior
6. (a) Industrial Finance Corporation of Thailand (IFCT)	(1) Borrowing long-term funds from both domestic and foreign sources (2) Extending medium- and long-term credits to industries	Ministry of Finance
(b) Small Industries Finance Office	Receiving funds appropriated from the government budget and then depositing them with the Krung Thai Bank. Krung Thai Bank also provides matching amounts to SIFO's account-at the ratio of 3 to 1 - for the purpose of lending to small industries	Ministry of Finance and Ministry of Industry

Source: Thailand Development Research Institute (TDRI). "1986 Year-End Conference on Financial Resources Management." Unpublished (December 1986).

forms. One is the extent of participation of foreign banks in the financial system of ASEAN countries; and the other, the extent of participation of ASEAN banks in international banking. The substantial physical presence of branches of foreign banks in all ASEAN countries has already been noted above. This does not include the numerous representative offices of foreign banks in the ASEAN countries. There are more than 50 of them in Indonesia, 26 in Malaysia, 19 in the Philippines, 47 in Singapore, and 37 in Thailand. The combined assets of branches of foreign banks range from four percent to eight percent of the total assets of the financial systems in Thailand, Indonesia, Malaysia and the Philippines. This obviously understates the extent of participation of foreign banks in the financial system of these countries since aside from directly mobilizing deposits and lending to banks and nonbank enterprises, they also constitute important links between the ASEAN countries and international financial markets. In Singapore, the total assets of foreign (full and restricted license) and offshore banks accounted for 92 percent of the total assets of its commercial banking system in 1988. ^{12/} Although the Philippines has the lowest number of branches of foreign banks, 10 out of its 24 domestic universal/commercial banks have substantial foreign equity participation.

ASEAN banks have also participated in international banking. As shown in Table 15, ASEAN banks have a significant number of branches and subsidiaries in the Pacific region. This has shown to be increasing between the mid-1970s and 1983 at least for some large banks (see Table 16). At present, the 13 local full license banks of Singapore have a large network of overseas offices that include 96 branches, eight agencies, and 16 representative offices. The Thai local banks have 22 branches overseas. The Philippines have 14 branches, two agencies, and eight representative offices overseas. The record of intra-ASEAN exchange of banking facilities is not that impressive, however. There is more interaction between Malaysia and Singapore than the rest of ASEAN countries because of their strong historical ties (see Table 17). One encouraging note though is that except for Brunei, an ASEAN member country has at least one branch bank in another member country.

ASEAN banks appear to be active participants in the international interbank market (see Table 18). Indonesia, Malaysia and Thailand were net lenders in this market, whereas the Philippines and Singapore were net borrowers. Their net positions have improved between 1983 and 1988. As regards cross-border bank credit to nonbanks by residence of lending bank, only Singapore showed significant amount of activity due to the presence of its offshore banking system that is internationally

^{12/}

See Table 2.3 of Ariff et al. 1990.

Table 15
ESTABLISHMENT TRADE IN FINANCIAL SERVICES IN COUNTRIES
OF THE PACIFIC REGION

Country	Total Number of Branches and Sub- sidiaries of ASEAN Banks in Other Countries of the Pacific Region	Total Number of Branches and Sub- sidiaries of Banks of Other Countries in the Pacific Region Established in ASEAN Countries
INDONESIA	14	41
MALAYSIA	15	31
PHILIPPINES	33	33
SINGAPORE	52	113
THAILAND	22	30

Source: Kazumasa Iwata. "Liberalisation of Trade in Financial Services." Edited by Castle, Leslie V. and Christopher Findlay. Pacific Trade in Services. Sydney: Allen and Unwin, Inc., 1988.

Table 16
NUMBER OF OVERSEAS BRANCHES OF TOP TEN BANKS
IN ASEAN COUNTRIES

Rank	Bank Name	Mid-70s	1983	Change
INDONESIA				
	Bank Negara Indonesia	3	3	0
	TOTAL	3	3	0
MALAYSIA				
	Bank Bumiputra (M) Bhd	na	6	+6
	Malayan Banking Bhd	26	26	0
	United Malayan Banking Corp.	9	9	0
	TOTAL	35	41	+6
PHILIPPINES				
	Philippine National Bank	3 b/	4	+1
	Allied Banking Corporation	na	3	+3
	TOTAL	3	7	+4
SINGAPORE				
	Development Bank of Singapore	na	4	+4
	United Overseas Bank	4	32 a/	+28
	Overseas-Chinese Banking Corp.	31	31	0
	Overseas Union Bank Limited	19	18	-1
	Chung Khiaw Bank	16	18	0
	Lee Wah Bank	9	9	0
	TOTAL	81	112	+31
THAILAND				
	Bangkok Bank	15	12	-3
	Krung Thai Bank	0	1	+1
	Thai Farmers Bank	1	3	+2
	Siam Commercial Bank	0	2	+2
	TOTAL	16	18	+2

Notes: Banks are ranked by total assets in the year to 31 December 1982.
Of those banks with overseas branches among the top ten, each country branches have been listed.
a/ Two subsidiaries.
b/ Including agencies.

Source: John Newson. "The Internationalisation of Banking." Augustine Tan and Basant Kapur (eds.). Pacific Growth and Financial Interdependence. Massachusetts: Allen and Unwin, Inc., 1986.

Table 17
ASEAN: INTRA-ASEAN OPERATING COMMERCIAL BANKS, 1981

PARENT COUNTRY	BANK	HOST COUNTRY
Indonesia	(1) Bank Negara Indonesia	(1) Singapore
Malaysia	(1) Malayan Banking Berhad	(1) Brunei (2) Singapore
	(2) United Malayan Banking Corp.	(1) Brunei (2) Thailand
	(3) Ban Hin Lee Bank	(1) Singapore
	(4) Malayan United Bank	(1) Singapore
	(5) Bank Bumiputra Malaysia Berhad	(1) Singapore (offshore)
Philippines	(1) Philippine National Bank	(1) Singapore (offshore)
Singapore	(1) Overseas Union Bank	(1) Brunei (2) Malaysia
	(2) Chung Kiaw Bank	(1) Malaysia
	(3) Lee Wah Bank	(1) Malaysia
	(4) Overseas Chinese Banking Corp.	(1) Malaysia
	(5) United Overseas Bank	(1) Malaysia
	(6) Four Seasons Communication Bank	(1) Thailand
	(7) Int'l. Bank of Singapore	(1) Philippines (offshore)
Thailand	(1) Bangkok Bank	(1) Indonesia (2) Malaysia (3) Singapore

Source: Satalaksana, Dahlan M. "Commercial Banking Links in ASEAN." Staff Paper No. 15, SEACEN Research and Training Centre, 1986.

Table 18
 CROSS-BORDER INTERBANK CLAIMS AND LIABILITIES
 AND CROSS-BORDER BANK CREDIT AND DEPOSITS, 1983 AND 1988
 (In US\$ B)

Items	1983	1988
1. Cross-Border Interbank Claims by Residence of Lending Bank		
Indonesia	7.49	8.97
Malaysia	4.03	6.25
Philippines	2.47	3.80
Singapore	59.27	193.81
Thailand	1.88	6.20
2. Cross-Border Interbank Liabilities by Residence of Borrowing Bank		
Indonesia	0.92	0.64
Malaysia	1.80	1.64
Philippines	7.71	4.02
Singapore	70.33	202.95
Thailand	2.11	2.65
3. Net Position (= (1)-(2))		
Indonesia	6.57	8.33
Malaysia	2.23	4.61
Philippines	-5.24	-0.22
Singapore	-11.06	-9.14
Thailand	-0.23	3.55
4. Cross-Border Bank Credit to Nonbanks by Residence of Lending Bank		
Indonesia	-	-
Malaysia	1.66	0.85*
Philippines	0.65	0.46
Singapore	32.33	69.22
Thailand	0.35	0.78
5. Cross-Border Bank Deposits of Nonbanks by Residence of Borrowing Bank		
Indonesia	0.05	0.03
Malaysia	1.22	0.22
Philippines	5.28	2.31
Singapore	22.35	49.47
Thailand	0.32	0.67

* Only third quarter figures are available.

Source: International Financial Statistics, October 1989.

oriented. On the deposit side, again Singapore figured prominently. Philippines, which has an offshore banking system that is concentrating on raising funds, is a distant second.

III. STRUCTURES OF MARKETS AND COMPETITION

This section examines the structures of markets and competition of the ASEAN banking systems. In this regard, we look at certain indicators such as structure of ownership, policy on bank entry and branching, degree of concentration, and pricing.

A. Structure of Ownership

In this aspect, we focus on the relative share of government and the private sector in the ownership of financial institutions. It should be pointed out at the outset that a government-run financial institution is not necessarily inefficient. It could be efficiently managed as the privately run financial institution. However, if it is being conferred with special privileges and subsidies, then it would be very hard for private financial institutions operating in the same market to compete with it. An example is that a government bank is made the sole depository financial institution of all government-owned corporations. Access to cheap funds will allow itself to price its loans at below market rates. Even in the absence of special privileges and subsidies, being a government bank in itself already confers certain advantages. This is particularly true in countries where there is no deposit insurance scheme and the financial system is highly unstable.

Governments in ASEAN countries are not only involved in regulating financial institutions but also directly participate themselves in the provision of financial services through state-owned financial institutions. However, the degree of their involvement and their impact on the financial markets greatly vary among each other. In Indonesia, the government has substantial equity participation in practically all key financial institutions. It owns the five largest commercial banks with numerous branches nationwide, the largest development bank, the largest savings bank, the largest nonbank financial institution (NBFI) plus substantial equity participation in practically all NBFI, and the sole pawnshop with more than 400 branches all over the country. As Cole and Slade (1990) pointed out: "State-owned banks have paid lower interest rates on deposits than private banks throughout the period, but as there is no deposit insurance in Indonesia, State-owned banks may have appeared 'safer' to many depositors" (p. 43). It was only after the October 1988 deregulation that state-owned banks ended their monopoly of deposits of public corporations. Erquiaga (1987) observed that: "The state banks have come under increased scrutiny over the last

several years because of perceived operational inefficiencies compared to the foreign banks and some of the national commercial banks." (p.55)

The direct participation of government in banking is also visible in the financial landscape of Malaysia. Government ownership of financial institutions is pronounced in both the banking and nonbanking institutions. Lin *et al.* indicated that: "The commercial banking system is dominated by two largely government-owned commercial banks, accounting for 35.8 percent of the total assets of all commercial banks as at the end of June 1989; their branch network of 327 offices represented more than 35 percent of the total banking network." (p.11) However, these banks are considered to be efficiently managed. Both the privately owned domestic and foreign banks consider the financial market in Malaysia to be competitive. This is mainly attributed to the openness of its financial system.

In the Philippines, the government owns the largest universal bank, which has the most extensive branching network, and the largest development bank. Both of them suffered financial difficulty in the mid-1980s as a result of "behest loans" made by them during the previous regime. They were rehabilitated, but the government had to absorb their non-performing assets worth over P100 B. The government-owned universal bank is now in the process of being privatized, with 30 percent of its total outstanding shares already sold to the private sector. The government has still maintained the policy of requiring all government agencies and government-owned corporations to deposit their surplus funds only in government-owned banks.

Even Singapore which has a highly open financial system allows government participation in the banking system. However, its savings bank (POSB) is shown to be innovative and competitive, while the semi-governmental commercial bank (DBS) serves as a counterweight to the "Big Four" local banks so that its "presence has served to enhance the competitiveness of the banking system,...." (Ariff *et al.* 1990).

Perhaps, Thailand differs from the rest of the ASEAN countries in this area. Tan (1984) noted that the Thai "Government ownership and control of financial institutions and therefore the relative importance and number of specialized institutions are very small." (p. 45)

As regards foreign ownership of banks, Singapore ranks first in terms of the number of foreign-owned banks operating domestically. Indonesia, Malaysia and Thailand have ten or more branches of foreign banks that do domestic banking, whereas the Philippines has only four. But it should be noted that foreign banks have minority participation in ten domestic banks in the Philippines.

B. Policy on Bank Entry and Branching

This is one area where some ASEAN countries have made certain progress in the past few years to improve the competitiveness of their banking system. However, the degree of relaxation on bank entry significantly varies among ASEAN countries. In Indonesia, nationals may acquire a license to operate a bank anywhere in the country provided they meet the minimum capital requirement. Foreign banks are encouraged to have joint ventures with Indonesian nationals. This privilege is available only to those that come from countries with reciprocal agreement with Indonesia. They may own up to 85 percent of the outstanding equity shares of joint venture banks. This is an improvement over minority share allowed them before the PAKTO 27 (October 1988) reforms. However, they are restricted to only seven major cities and are required that within 12 months, their outstanding export credits be at least 50 percent of their total outstanding credits. In the meantime, no new branches of foreign banks will be allowed. As regards branching, banks wholly owned by Indonesian nationals may open branches anywhere in the country, whereas existing foreign bank branches may open one branch only in each of the seven major cities. Branches of foreign banks do not have rediscounting privileges with the central bank of Indonesia.

Malaysia's policy on bank entry and branching remains the same. In particular, no new banks are allowed to enter the Malaysian financial system, and its policy toward foreign bank operation does not encourage the establishment of more branches in the country. Opening of new branches is allowed only to local banks. Branches of foreign banks do not have rediscounting privileges with the central bank of Malaysia.

The Philippines has recently relaxed its policy on bank entry and branching. The Monetary Board has been processing some applications for bank entry that include equity participation by foreign banks. The present law allows foreign investors to own up to 30 percent of the outstanding shares of a domestic bank. Entry by branches of foreign banks is still restricted. Instead, foreign banks are being encouraged to establish offshore banks in the Philippines or buy equity shares of existing domestic banks. It seems that only Indonesia and the Philippines encourage joint venture banks at present. Existing branches of foreign banks may open branches in other parts of the country but they are not allowed to accept demand deposits. This restriction has the same effect as the restriction on branching since demand deposit is a key service facility offered by branches of foreign banks. Like domestic banks, branches of foreign banks have rediscounting privileges with the central bank of the Philippines.

Thailand has not allowed new entrants into its commercial banking system for quite sometime already. Instead, local banks have been encouraged to open branches in rural areas. Branches

of foreign banks are still prohibited from establishing branch networks anywhere in the country. Like local banks, they have rediscounting privileges with the central bank of Thailand.

C. Degree of Banking Concentration

We use here two measures of banking concentration, namely: the asset share of the five biggest banks to the total assets of banks in each country and the Herfindahl index. Only those domestic and branches of foreign banks belonging to the commercial banking system are included. The results are shown in Table 19.

In both measures, it appears that Indonesia has the highest degree of banking concentration. The first five banks, which happen to be all state-owned banks, constitute 81 percent of the total assets of the commercial banking system. Thailand follows Indonesia, with the five largest banks accounting for 68 percent of the total assets of commercial bank assets. Note that Thailand has the biggest commercial bank in the region with total assets amounting to about US\$17 B. Philippines appears to have the lowest concentration ratio. This is because more than half of the assets of a government-owned commercial bank that were deemed nonperforming had been recently transferred to the national government.

In general, the findings shown in Table 19 suggest that a high degree of banking concentration exists in the four ASEAN countries.

D. Pricing

The structure of the market could be reflected in the spread between the cost of funds and the lending rate. An inefficient banking system characterized by greater concentration is likely to be associated with a larger bank spread.

Figure 2 shows the behavior of bank spread for ASEAN countries for the period 1982 to 1988. For purposes of comparison, the patterns of bank spread for the U.S.A., Japan, and Germany are also shown in the same table. As expected, the Philippines, Thailand and Indonesia have on the average larger bank spreads than Malaysia and Singapore. It is, however, to be noted that the bank spreads for the Philippines, Indonesia and Thailand have declined in the past two years.

The openness of the financial systems of Singapore and Malaysia could have acted as a strong pressure on bank spread. Malaysia and Singapore are even found to have lower average bank

Table 19
CONCENTRATION IN ASEAN COMMERCIAL BANKING SYSTEMS, 1988

	INDONESIA	MALAYSIA	PHILIPPINES	SINGAPORE	THAILAND
1. Share of five largest banks in total assets (%)	80.8	54.0	46.3	57.5	67.9
2. Herfindahl concentration index	0.144	0.077	0.062	0.073	0.129

Notes: Figures for Indonesia are as of 1986.

$$\text{Herfindahl Index} = \sum_{i=1}^n (M_i^2)$$

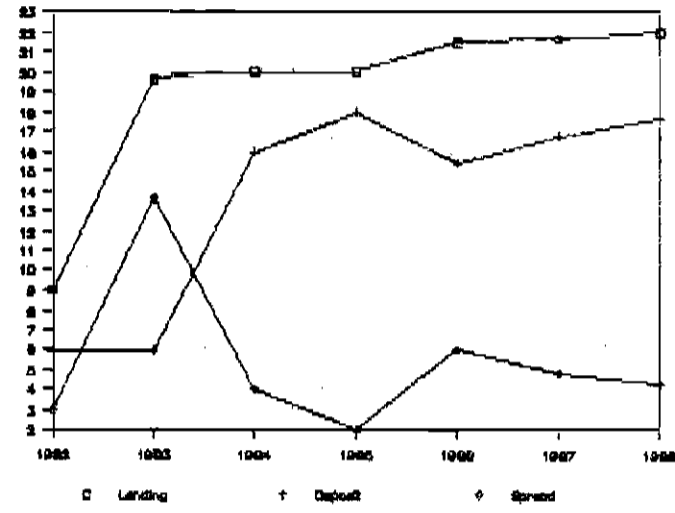
where M_i = market share of bank i
based on total assets ($i = 1, 2, \dots, n$)

Sources of Basic Data:

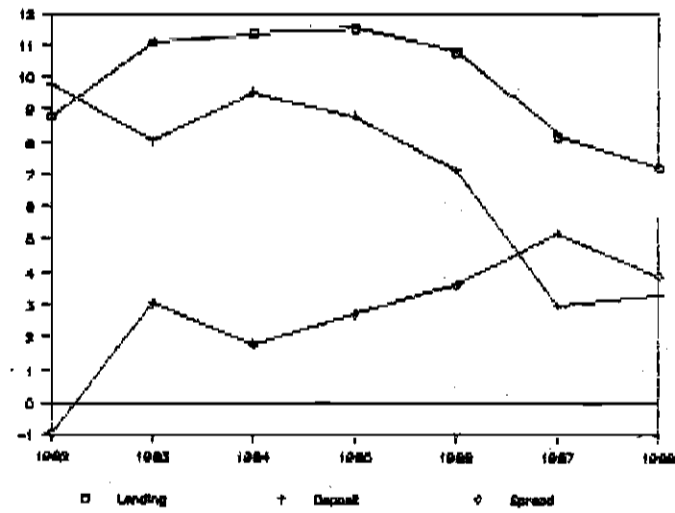
- (1) Philip Erquiaga. "Improving Domestic Resource Mobilization Through Financial Development - Indonesia." ADB Staff Paper No. 40 (1987).
- (2) Lin See-Yan, et al. "Money Markets in Malaysia." Unpublished (1990).
- (3) Central Bank of the Philippines, Fact Book: Fin'l. System of the Phils. (1988).
- (4) Bank of Thailand. "Commercial Banks in Thailand." (December 1989).

Figure 2
**NOMINAL LENDING RATES, DEPOSIT RATES
 AND GROSS SPREAD IN ASEAN**
 (In % per annum)

INDONESIA			
	Lending	Deposit	Spread
1982	9.00	6.00	3.00
1983	19.63	6.00	13.63
1984	20.06	16.00	4.06
1985	20.03	18.00	2.03
1986	21.49	15.43	6.06
1987	21.67	16.78	4.89
1988	22.04	17.72	4.32
AVERAGE	19.13	13.70	5.43
STD.DEV	4.23	4.94	3.56



MALAYSIA			
	Lending	Deposit	Spread
1982	8.79	9.75	-0.96
1983	11.08	8.02	3.06
1984	11.35	9.54	1.81
1985	11.54	8.81	2.73
1986	10.80	7.17	3.63
1987	8.19	3.00	5.19
1988	7.25	3.33	3.92
AVERAGE	9.86	7.09	2.77
STD.DEV	1.61	2.61	1.81



SINGAPORE			
	Lending	Deposit	Spread
1982	10.23	7.22	3.01
1983	9.05	6.31	2.74
1984	8.97	6.98	1.99
1985	7.93	4.99	2.94
1986	6.82	3.91	2.91
1987	6.10	2.89	3.21
1988	5.96	2.74	3.22
AVERAGE	7.87	5.01	2.86
STD.DEV	1.51	1.74	0.39

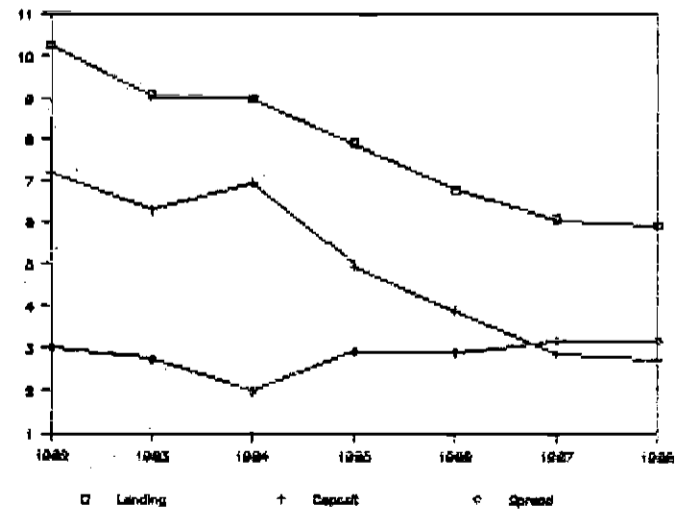
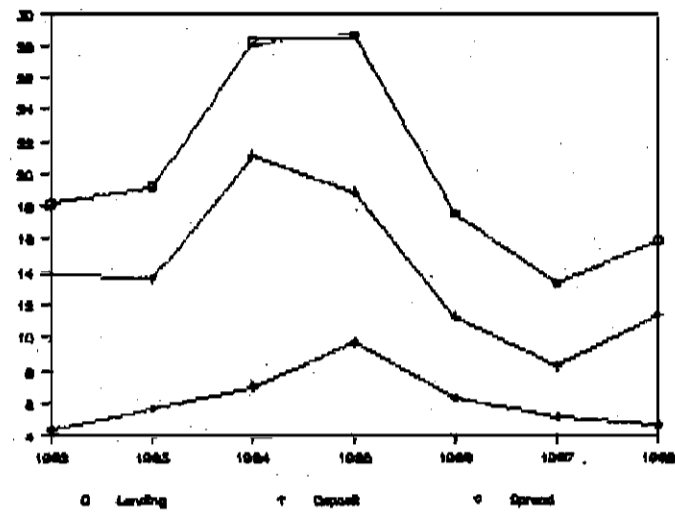
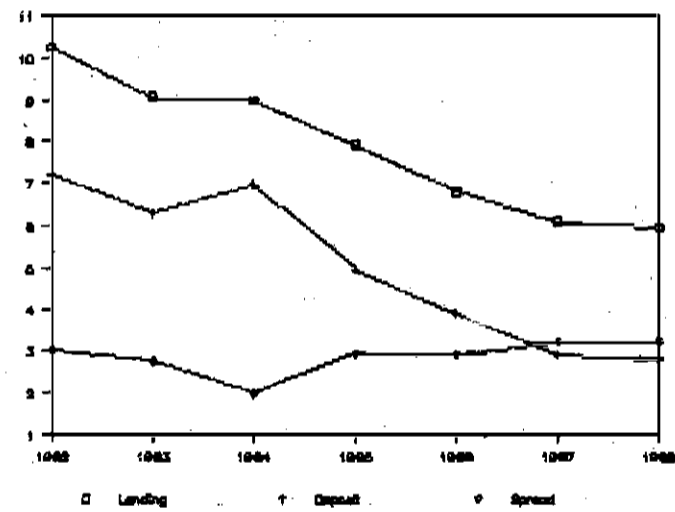


Figure 2 (cont'd.)

PHILIPPINES			
	Lending	Deposit	Spread
1982	18.12	13.74	4.38
1983	19.24	13.58	5.66
1984	28.20	21.17	7.02
1985	28.61	18.91	9.70
1986	17.53	11.25	6.28
1987	13.34	8.20	5.14
1988	15.92	11.32	4.61
AVERAGE	20.14	14.03	6.11
STD.DEV	5.51	4.21	1.70



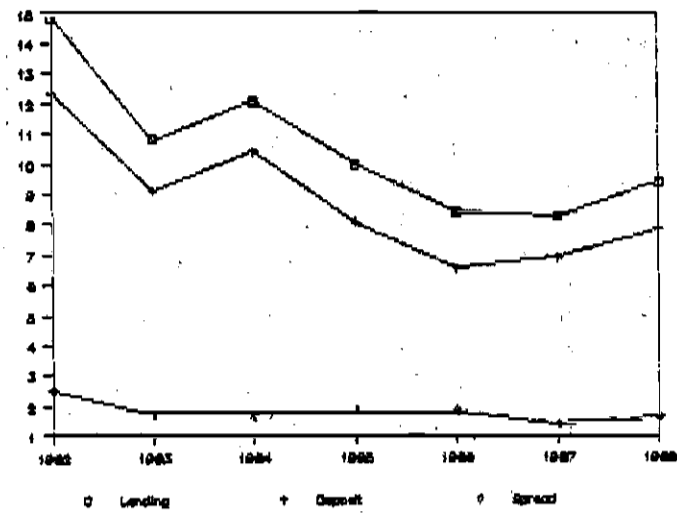
THAILAND			
	Lending	Deposit	Spread
1982	19.00	13.00	6.00
1983	17.63	13.00	4.63
1984	18.75	13.00	5.75
1985	19.00	13.00	6.00
1986	17.00	9.75	7.25
1987	15.00	9.50	5.50
1988	15.00	9.50	5.50
AVERAGE	17.34	11.54	5.80
STD.DEV	1.63	1.69	0.73



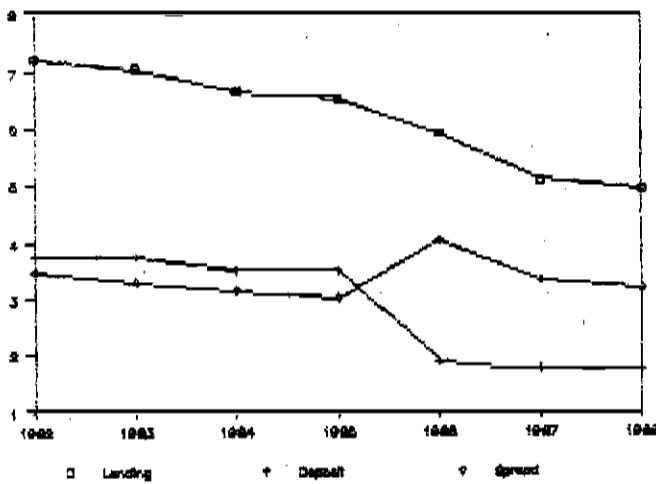
Note: In the absence of data, WEIGHTED AVERAGE COMMERCIAL BANK RATES were used for the 1983-85 Lending Rates in Indonesia.

Figure 2 (cont'd.)

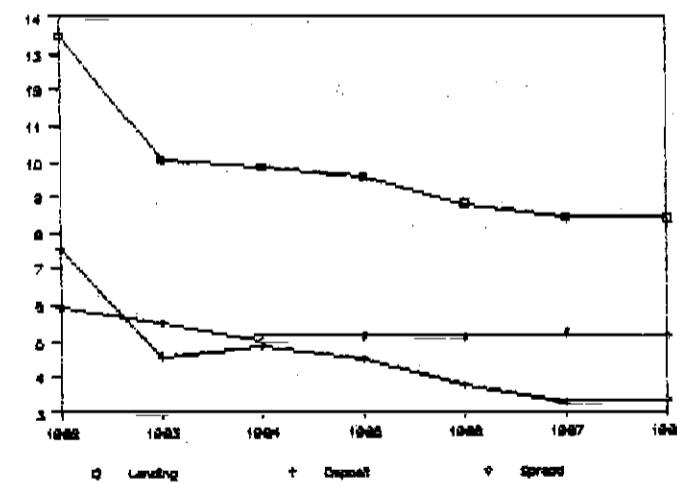
UNITED STATES			
	Lending	Deposit	Spread
1982	14.86	12.35	2.51
1983	10.79	9.09	1.70
1984	12.04	10.37	1.67
1985	9.93	8.05	1.88
1986	8.35	6.52	1.83
1987	8.21	6.86	1.35
1988	9.32	7.73	1.59
AVERAGE	10.50	8.71	1.79
STD.DEV	2.17	1.92	0.33



JAPAN			
	Lending	Deposit	Spread
1982	7.23	3.75	3.48
1983	7.05	3.75	3.30
1984	6.66	3.50	3.16
1985	6.52	3.50	3.02
1986	5.91	1.88	4.03
1987	5.09	1.76	3.33
1988	4.93	1.76	3.17
AVERAGE	6.20	2.84	3.36
STD.DEV	0.85	0.91	0.31



GERMANY			
	Lending	Deposit	Spread
1982	13.50	7.54	5.96
1983	10.05	4.56	5.49
1984	9.82	4.86	4.96
1985	9.53	4.44	5.09
1986	8.75	3.71	5.04
1987	8.36	3.20	5.16
1988	8.33	3.29	5.04
AVERAGE	9.76	4.51	5.25
STD.DEV	1.65	1.37	0.33



Sources of Basic Data:

International Financial Statistics, October 1989.

Erquiaga, Philip. "Improving Domestic Resource Mobilization Through Financial Development: Indonesia." ADB Economic Staff Paper No. 40, November 1987.

spreads than Japan and Germany. The U.S.A. has the thinnest spread among the countries included in Figure 2. ^{13/}

The larger bank spreads observed for the Philippines, Thailand and Indonesia cannot be wholly attributed to the kind of market structures existing in these countries. Regulatory measures, such as those pertaining to intermediation taxes (e.g., high reserve requirements, mandatory credit allocations to certain priority sectors, etc.) could also be contributory to the large bank spread. ^{14/} The pieces of evidence available for the Philippines seem to support this (see Table 20). For Thailand, the cost of said regulations comprises about 30 percent of commercial banks' spread between lending and deposit rates. ^{15/} Thus, intermediation taxes aggravate the plight of borrowers in a less competitive financial system.

^{13/}

Indeed, Ariff *et al.* (1990) have pointed out that the openness of the financial system of Singapore "serves to place a limit on the permissible width of spreads" (p. 26). Also, it "is generally believed that the DBS' presence has served to enhance the competitiveness of the banking system, in terms of a narrowing of the spread between lending and deposit rates" (p. 29). DBS is a semi-government bank that intensely competes with private banks.

^{14/}

In the Philippines, all banks are required to allocate at least 25 percent of their total loanable funds to agriculture and beneficiaries of agrarian reform. In Thailand, commercial banks must extend credits for the purpose of rural development in the amount of at least 20 percent of deposit liabilities as of the end of the previous year. In Indonesia, national banks are required to allocate a minimum of 20 percent of loan portfolio to small business. These are examples of mandatory credit allocations. Mandatory credit allocations could lead to the widening of bank spread. In the Philippines, for example, banks that do not wish to lend to the agricultural sector may buy government securities as a substitute for their compliance of the regulation that they allocate 25 percent of their total loanable funds to the said sector. The interest rate on government securities eligible for such purpose is fixed at a level substantially below the prevailing lending rates (and at times, even below the deposit rate). Banks recoup their losses here by passing them on to borrowers in terms of higher lending rates.

^{15/}

See Thailand Development Research Institute (1987).

Table 20
INTERMEDIATION MARGIN, 1983 and 1986
PHILIPPINES

	1983	1986	
A. Intermediation margin, as % of earning assets			
1. Average cost of deposit	10.02	7.32	
2. Net of 20% tax on interest income from deposits	8.02	5.86	
3. Cost of loanable funds	12.67	8.92	
4. Average lending rate	15.01	14.62	
5. (4) net of 5% gross receipts tax (GRT)	14.26	13.89	
6. Bank margin (5) - (3)	1.59	4.97	
7. Total margin to clients (4) - (2)	6.99	8.76	
B. Composition of the total margin (7) in %			
1. Depositor	53.40	40.05	
2. 20% tax on interest income from deposits	13.35	10.01	
3. Reserve cost	17.67	10.96	
4. GRT	5.00	5.00	
5. Bank margin	10.57	33.97	
T O T A L	100.00	100.00	
<hr/>			
	1984	1985	1986
C. Components of bank margin (% of total assets)			
1. Intermediation margin	5.04	6.02	5.07
2. Staffing cost	1.06	1.23	1.38
3. Administrative cost	1.48	1.50	1.57
4. Depreciation	0.83	1.00	0.86
5. Total cost	3.37	3.01	3.8
6. Profits before taxes	1.67	2.21	1.9
D. Staffing expenses as % of total assets			
1. All banks	0.90	1.00	1.40
2. Sound domestic banks	1.00	1.20	1.40
3. Foreign banks	0.40	0.70	1.00

Table 20 (cont'd.)

E. Comparative bank margin

	Staffing Cost	Adm. Cost	Depr.	Total Cost	Profit before taxes	Total Margin
Phil. (1986)	1.4	1.6	0.9	3.9	1.9	5.8
Selected countries ca. 1980						
Belgium	2.2	0.5	0.3	3.1	0.3	3.4
Denmark	2.0	0.9	0.7	3.6	0.7	4.3
Finland	1.6	1.6	0.7	3.9	0.4	4.4
Morocco	2.2	0.8	0.7	3.7	1.9	4.0
Norway	2.1	1.4	0.5	4.0	0.3	4.5
Pakistan	1.7	0.8	0.1	2.6	0.7	3.3
Portugal	2.0	0.7	1.5	4.2	0.3	4.5
Spain	2.8	0.8	0.6	4.2	1.5	5.7
A V E R A G E	2.1	0.9	0.6	3.7	0.7	4.4

Notes: The 20 percent tax on interest income from deposits is a final tax. The five percent gross receipts tax (GRT) is imposed on all receipts (including both interest and capital gains of a bank). It cannot be used as a credit against income tax. Cost of loanable funds includes average cost of deposits and reserve costs (including the cost attributable to the requirement to lend 25% of a bank's total resources to agriculture and beneficiaries of agrarian reform program). Domestic banks were classified into sound and weak banks on the basis of their return on risk loans, return on total assets, past due loans and provisions therefore, potential loan losses, and adjusted capital/total assets.

Source: World Bank. Philippines Financial Sector Study (August 1988).

IV. BENEFITS AND COSTS OF A MORE LIBERAL REGIME FOR INTERNATIONAL TRADE IN BANKING SERVICES IN THE ASEAN REGION

This section discusses the benefits and costs of a more liberal regime for international trade in banking services in the ASEAN region. There are two aspects of internationalization of finance, namely cross-border and establishment-related trade in financial services. This paper focuses on the latter. Establishment-related trade in banking services refers to "services produced by factors of production whose ownership resides in one country and sold to residents of another through some form of direct presence of the supplier in the client's country." (MTN.GNS/W/68, 4 Sept. 1989; p.6)

A. Benefits

There are benefits to a more liberal regime for international trade in banking services in the ASEAN region. First, it improves access of the population to banking services in general. It has been shown above that except for Singapore, ASEAN countries are still generally underbanked. Also, the distribution of bank services is badly skewed in favor of the capital city (i.e., Metro Manila for the Philippines, Bangkok for Thailand, and Jakarta for Indonesia). The recent liberalization on bank entry and branching in most ASEAN countries is indeed a welcome development. It could perhaps be extended to branches of foreign banks. But their contribution to banking development in the country would likely be limited if they are confined to locate only in the capital city of the country concerned. As already pointed out above, all ASEAN countries have already several branches of foreign banks located and operating in capital cities. Thus, allowing new branches of foreign banks to be established in other places within the country other than the capital city would be more desirable than having them situated in a capital city. It is equally desirable to allow branches of foreign banks that are already operating in ASEAN countries to have branch networks in other places within the country concerned other than the capital city. Indonesia has already started doing this.

Second, it encourages foreign investors to locate themselves in areas other than the capital cities of ASEAN countries. This augurs well for a more balanced regional development within a country which has been the obsession of policymakers for decades. It is to be noted that in the past decade, ASEAN countries have heavily invested in infrastructural development in certain regions within their territories to induce foreign investors to locate themselves in those areas. The immediate availability of services from international banks with which they have long established relationship will further strengthen their decision to locate in those areas because aside from ordinary banking services, they may also require from their preferred banks

ancillary banking services, such as payroll services, portfolio investment, etc. The delivery of such services requires the physical presence of their banks in the area.

Third, increased competition in the banking system can be extended to other regions or areas of the country with the presence of foreign banks in those areas. Thus, more people will be exposed to a wider set of financial instruments with more attractive rates of returns. So far, foreign banks' competition with domestic banks has been confined to the capital city of the country that benefited only wealthier residents. This is so because of the host government's policy of disallowing branches of foreign banks to establish branch networks in other parts of the country.

And lastly, improvements in intra-ASEAN trade and investment, which ASEAN countries have been diligently working on as may be observed from the various activities that have already been done and are being lined up for this purpose, would require better banking infrastructure. Such could be achieved through a more liberal regime for regional and international trade in banking services. The competitiveness of ASEAN banks that would result from a more liberal financial system at home will prepare them to participate in regional and international banking. Indeed, the experience of Singapore in this area is worth considering.

B. Costs

Any undertaking always involves some costs that must be weighed against the benefits. The move towards more liberal regime for international trade in banking services has some costs. Deregulation might breed excessive risk-taking among competitors. This is worse in a country where there is a compulsory deposit insurance scheme because of the moral hazard problem that it may generate. The Philippines is a case in point. However, even in those countries where no deposit insurance scheme exists, the policy of bailing out any ailing bank could be considered by market participants as a form of insurance. Thailand could serve as an example here. In both cases, the government concerned will have to bear the burden of those losses. Of course, the other alternative is to allow bank failures and let the participants absorb all the costs. But it generates another cost, i.e., it undermines the people's confidence in the banking system, which might turn out to be more costly in the long-run. This only serves to underscore the importance of having a strong and efficient supervisory organization as well as effective prudential regulations in ASEAN countries. This, too, involves additional costs since supervisory staff have to be trained and paid well.

During the heyday of low interest rate in the international market, several countries refused to make adjustment to correct

their worsening current account imbalances since cheap funds were readily available from the international market to finance such deficits. The Philippines was one of them. ^{16/} With a more liberal regime for international trade in banking services, the inflow of foreign capital that might be facilitated by branches of foreign banks could hide any imbalances in the current account. ^{17/}

Finally, the present superiority of foreign banks over domestic banks in technology-based transactions, which most banking services are now, could result in undue competition. ^{18/} Monetary authorities may end up supervising more foreign banks than domestic banks. Apart from supervisory problem that may arise from this, the effectiveness of monetary policy could be undermined. This could be one of the reasons why ASEAN countries prefer to promote joint ventures than allow new branches of foreign banks to enter the domestic financial system.

It is our view that the benefits that will be derived from a more liberal regime for international trade in banking services in ASEAN countries outweigh the costs. However, the liberalization should be done gradually and should be in step with the development of the economy. The timing of the liberalization is also important.

V. THE APPLICABILITY AND IMPLICATIONS OF THE URUGUAY ROUND KEY CONCEPTS, PRINCIPLES AND RULES

This section discusses the applicability and implications of the key concepts and principles discussed in the multilateral negotiations on trade in services to the banking sector in the ASEAN countries. Since MTN.GNS/35: "Draft: Multilateral Framework for Trade in Services" (23 July 1990), MTN.GNS/FIN/W/1: "Proposal by the European Community: Draft Financial Services Annex to the Agreement on Trade in Services" (10 July 1990), and MTN.GNS/FIN/W/2: "Submission by the United States on Financial Services" (12 July 1990) are already available, this paper will also comment on some of the substantive contents of these

^{16/}

See Lamberte *et al.* (1985).

^{17/}

See Iwata (1988). The literature on the order of economic liberalization provides ample lessons on this. See, for example, Edwards (1985) and Corbo and de Melo (1987).

^{18/}

This could arise from economies of scale. For instance, a multinational bank may develop its own computer software for market analysis that can be used by its branches all over the world.

documents. In this regard, Cornford's (August 1990) comments on the proposals of the European Community and United States concerning an agreement regarding international trade in financial services are very relevant.

Before we proceed with the assessment of the applicability and implications of the concepts, principles and rules, it would be worthwhile to briefly comment on the emerging consensus on the need to have a sectoral annotation to the general framework agreement for banking services. The services sector in general is a fairly heterogeneous group of economic activities. Each sub-sector also consists of finer groupings of economic activities. But the banking sector clearly stands out among the other sub-sectors in the services sector. Its function in the economy is unquestionably large. A significant portion of the trade in goods and services, both domestic and international, passes through the banking system. Thus, a dysfunctional banking system certainly impairs trade. Aside from this, the banking system also provides portfolio investment services to customers. In most of these transactions, the physical presence of banks near their clients is very important.

Monetary policy is transmitted to the rest of the economy through the banking system. Thus, there is a strong motivation for monetary authorities to maintain a well-functioning banking system. It is then understandable that the banking sector is one of the highly regulated sectors in the economy ostensibly to preserve the payments system and protect consumers so that their confidence in the banking system will be maintained.

The banking sector has been experiencing a rapid innovation especially with the advancement in communications and computer. This may be gathered from the variety of financial services and instruments that are currently available in the market. With the further deregulation of the financial markets in both developed and developing economies, financial institutions will certainly be busier in developing more financial services and instruments. Thus, both the wholesale and retail markets for financial services will become more complex and sophisticated than what they are already now.

A framework agreement that is applicable to all service sectors is highly desirable. However, if it is expressed in a very general manner and does not address the specificities of the banking sector, it will likely lead to more disputes that in the end would only render the agreement useless. Thus, it is necessary to have a sectoral annotation to the general framework to address the specificities of the banking sector so that resort to dispute settlement procedures will be minimized.

A. Transparency

It is not uncommon to see various branches of the government of ASEAN countries involved in promoting, regulating and

supervising the same business entities. Each one of them issues specific guidelines that are not usually well circulated. Neither are these activities well coordinated. Going through the exercise of knowing what guidelines apply and where to obtain them already entails too much effort and money for local residents. For foreigners, this is almost impossible to do especially if those guidelines are written in local languages. Thus, for ASEAN countries, there is a need to consolidate all those regulations and guidelines pertaining to banking laws, in general, and to laws covering trade in banking services, in particular. Each country may assign an office which can serve as a "one-stop shop" for all those laws, regulations and guidelines affecting trade in banking services. This may be patterned after the "one-stop shop" for the export sector that all ASEAN countries have, although in a limited scale. It is preferable that this office be housed at the Central Bank. All government agencies should be required to submit to this office all laws, regulations and guidelines, and any amendments thereof, that have some effects on banking operations. All inquiries pertaining to specific laws or guidelines in banking, either from own citizens or foreigners, will be addressed to it. All branches of foreign banks should likewise be required to submit to this office any information about their operations.

At the ASEAN level, the Committee on Finance and Banking (COFAB) may serve as a "one-stop shop" by consolidating what each member had already done. Thus, any interested third party does not have to contact each individual country office if he wants to make inquiries about banking laws, regulations and guidelines from all the ASEAN member countries.

B. Progressive Liberalization

As already pointed out above, ASEAN countries are now in different stages of financial liberalization. Leading the pack in this effort is Singapore. The remaining ASEAN countries have now gradually shifted their attention from credit allocation to the general soundness and stability of the financial system. The need for strong and efficient supervision is clearly felt in these countries. Since such supervision takes time to develop, ASEAN countries should opt for a gradual but progressive liberalization process. Singapore followed this track before.

The changing role of existing branches of foreign banks in the ASEAN region must also be recognized. In the past, they had been heavily involved in the financing of imports of multinational companies, most of which were established during the import substitution regime of these countries, and in packaging sovereign loans. As noted in Section I of this paper, their business for the latter had substantially declined as a result of the international debt crisis. At the same time, ASEAN countries that used to be inward looking have now switched towards export-orientation and more industrial dispersal of

industries. Thus, there is increasing activity in this area in which branches of foreign banks are not able to participate due to existing regulations, such as prohibition against opening branches outside the capital cities. This still exists today despite the fact that ASEAN countries, except Singapore, are generally "underbanked." Thus, there seems to be some scope for allowing foreign banks to be included in ASEAN countries' on-going financial liberalization.

Since the presence of branches of foreign banks operating in the capital cities of ASEAN countries is already substantial, branch networks of foreign banks may be established in areas outside the capital cities. This will extend the competition between foreign and local banks in the countryside, and at the same time, surplus units and foreign investors who locate themselves in the countryside will be offered a wider menu of banking services. This may be accompanied with the promotion of joint ventures. Although most ASEAN countries have already maintained such policy, the extent of equity participation by foreign banks in joint ventures may be increased.

C. Market Access

ASEAN countries have been exercising control over market access to their financial systems to pursue certain objectives, such as maintaining the stability of the financial system and effectiveness of monetary policy, configuring the structure of their financial systems to meet changing needs of the economy, developing banking skills of local professionals, etc. The framework agreement should allow ASEAN countries to exercise certain flexibility so that they can continue to pursue those objectives while they proceed with their financial liberalization. In this regard, certain aspects of the financial systems of ASEAN countries must be considered. One is the substantial presence of foreign banks in ASEAN countries in the form of branches, joint ventures, agencies and representative offices. This serves as a testimony that they recognize the importance of the commercial presence of foreign financial institutions in various forms for the delivery of financial services. However, granting market access automatically to all signatories at this time may not be advantageous to ASEAN countries since, given the substantial presence of foreign banks in these countries, it could easily lead to a situation wherein foreign banks would dominate their financial systems. A quota system wherein ASEAN countries determine the number of additional foreign banks that would be permitted to have commercial presence in their markets may be necessary. This may be applied to all forms of commercial presence of foreign banks, except in the case of joint ventures, provided that nationals retain control over the financial institutions. The quota system should be applied in a nondiscriminatory manner.

Another aspect is the trend towards universal banking or the blurring of distinctions among different types of financial

institutions. It should be noted that ASEAN countries are gradually moving, though at different speeds, toward this direction. Thus, in the long-run, the use of market access to develop or improve the efficiency of particular sub-markets may not be relevant anymore. In the short-run, however, the use of market access for such purposes is still relevant. One reason is that regulations that distinguish different types of financial institutions still exist. Another reason is that some sub-markets of the ASEAN financial systems are not yet well developed and that there are no operative prudential regulations covering those markets. Thus, universal market access at this stage of the development of the ASEAN financial systems may not be granted.

D. National Treatment

The Montreal document state that: "When accorded in conformity with other provisions of the multilateral framework, it is understood that national treatment means that the services exports and/or exporters of any signatory are accorded in the market of any other signatory, in respect of all laws regulations and administrative practices, treatment 'no less favourable' than that accorded domestic services or services providers in the same market." This has substantial impact on the current policy of ASEAN countries on branches of foreign banks, but less on joint ventures and other forms of commercial presence of foreign banks. The typical forms of discrimination exercised by ASEAN countries against foreign banks include, among others: ban on the establishment of branches; limit on the range of banking services they can offer, such as trust business; no access to refinancing facilities; and prohibition against purchasing local properties for business purposes. ^{19/} Of course, the degree of restrictiveness varies across ASEAN countries. Given the situation that most areas outside the capital cities of ASEAN countries are still underbanked, the changing pattern of the business of branches of foreign banks, and the export-orientedness of ASEAN countries, there seems to be a good reason for including foreign banks in the branching deregulation currently being undertaken by ASEAN countries. As regards the range of services that may be offered by branches of foreign banks, this may be gradually liberalized in step with the move towards universal banking.

It might be appropriate at this point to comment on the proposals of the EC and US on market access and national treatment since both proposals seem to very closely link market access to national treatment (Cornford 1990). Cornford's view of distinguishing the issues under market access from those under national treatment should be subscribed by ASEAN countries. As

^{19/}

These are mentioned in Naya et al. (1989) and also indicated in the discussion in the previous sections.

regards market access, the US proposal which also reflects that of the EC proposal states that: "Each party (a) shall permit financial service providers of another Party to establish or expand an enterprise for the provision of a financial service, and (b) shall permit such enterprises to provide financial services and to conduct activities associated with the provision of financial services." This is going far beyond what ASEAN countries can possibly offer. As regards (a), ASEAN countries will be obliged to open their markets to all signatories. As already mentioned above, foreign banks can easily overwhelm the market since there is already a substantial number of foreign banks currently operating in various forms in ASEAN financial markets. It may well be for ASEAN countries to resort to a quota system if they think that additional foreign banks can be accommodated by the financial system. What may be conceded by ASEAN countries is the relaxation of the prohibition against foreign banks to expand their business through branching within each ASEAN country's territory for reasons already cited above. As regards part (b), it obliges ASEAN countries to grant universal license to foreign service providers while such license is selectively given to domestic financial institutions. Even universal banks in ASEAN countries are not permitted to provide all the financial services mentioned in the US and EC proposals. For instance, financial leasing is not allowed to existing ASEAN universal banks. Also, there are financial services mentioned in both proposals that are not yet well-developed in ASEAN countries, hence there are virtually no regulations covering them. Once developed or fully appreciated by ASEAN countries, there might be a need to introduce new regulations for prudential reasons that might include restricting the benefits already enjoyed by financial services providers of other parties. Under Article 7.2 of the EC proposal, this cannot be done anymore once signatories agree to their proposal.

As regards national treatment, both the EC and US proposals are concerned more about the results of having a competitive environment than on the policy of promoting competition per se in the markets. Cornford is right in his observation that "equality of competitive opportunity" seems an untried but potentially more intrusive obligation than like treatment as regards taxation and regulation" (p.4). New entrants may be in a disadvantageous position compared with those that have been in the market for a long time, and some of them may not survive under an environment of stiff competition. This situation may be interpreted as not promoting "equality of competitive opportunity" since the results seem to be unfavorable to certain parties, although the policy environment promotes competition. Still, another example wherein the results of having a competitive environment can be distinguished from the policy of promoting competition per se in the markets could be cited. As already mentioned above, ASEAN countries, except Singapore, still maintain loan portfolio allocation policy because they expect their banking system to perform developmental functions aside from commercial functions.

Thus, they require banks to lend to priority sectors, such as agriculture and small and medium industries. Even if such policy is applied equally to all banks in their territories, foreign banks may be placed in a disadvantageous position because of their unfamiliarity with the sectors and probably, the relatively higher transaction cost they incur for granting small loans when their operations are designed for the wholesale market. Again, this could be interpreted as not promoting "equality of competitive opportunity." To deal with this issue, the US proposal recommends the provision that "No party shall establish or maintain any measure that requires that financial service be provided by financial service providers of that Party" (p.3). While many analysts would like to see this being done, it might take ASEAN countries some time to dismantle their credit allocation policy given the circumstances under which they were introduced and maintained.

E. Most-Favored-Nation/Nondiscrimination

Under this concept, all signatories to the sectoral annotation on banking services will guarantee that concessions made by one party would be equally accorded to all. This concept in its purest form may lead to unlimited entry by foreign financial services providers into the ASEAN countries' financial markets. This is more problematic to those countries that do not have yet well developed prudential regulations and efficient supervisory institution. More specifically, as regards opening the financial markets, ASEAN countries may suggest a phased liberalization consistent with the level of financial development of each country. Thus, the speed of liberalization in all or in some sub-sectors of the financial system may be different among parties -- faster for countries with more developed financial systems and slower for countries with less developed financial systems. ASEAN countries should stress this so that they will be accorded greater flexibility in opening up their financial markets. The quota system mentioned earlier should be resorted to. Furthermore, the quota system to be used in allocating additional slots for foreign financial services providers and the rules for implementing it should also be agreed upon in this sectoral annotation. At this point, it might be important for ASEAN countries to stress on the need to spread the representation of the banks among geographical areas for purposes of promoting and diversifying trade and investment.

F. Increasing Participation of Developing Countries

As already mentioned above, ASEAN banking systems are already participating in international banking, although still in a small way. This can further be increased if ASEAN countries successfully hurdle at least two obstacles. One is the strengthening of their financial systems, in general, and the individual financial institutions, in particular. This hinges on a number of factors, such as improvement in their prudential

regulations, availability of skilled manpower, adequate computer and communication facilities, etc. Joint ventures with foreign banks and the requirement to hire local professionals in important positions of foreign banks could be one of the ways to deal with the problem of lack of banking expertise in ASEAN countries. More competitive banks at home managed by professional bankers can easily integrate themselves in the international banking community. This should be taken into consideration in the liberalization process because premature or indiscriminate liberalization could lead to greater concentration of the ASEAN financial markets in foreign hands. Under this situation, there will be no ASEAN bank to speak of that could participate in international banking.

The second obstacle that ASEAN countries must hurdle is that of increasing their trade and investment. ASEAN banks could follow the business of their nationals in other countries. The volume of business should reach a certain level that can sustain the initial operations of ASEAN banks in those countries. As banking business expands, branches/subsidiaries of ASEAN banks can perhaps start extending banking services to nationals of host countries. This is a long shot for ASEAN countries, and it greatly depends on how their export of goods and capital are treated in host countries.

G. Regulatory Situation

The Montreal document is very much relevant to ASEAN countries in this aspect. It recognizes the right of countries to introduce new regulations. Regulations are needed even in the process of liberalization to finetune the financial system so that the effectiveness of monetary policies shall be maintained. As already noted above, some of the banking institutions and banking activities may be new to the ASEAN banking systems, hence prudential regulations are needed to maintain the integrity of the financial system as well as protect depositors and investors. Some ASEAN countries are in the process of reorganizing their regulatory bodies. In the Philippines, for example, there are a number of bills that seek to reform the key regulatory bodies, such as the Central Bank, the Securities and Exchange Commission to make it the lead agency in the capital market, and the Philippine Deposit Insurance Corporation. Thailand and Indonesia are not far behind in this process.

The EC and the US seem to have different views in this area. The EC proposal allows new regulations that may be introduced after the agreement only to "prevent or solve a serious economic crisis or financial disturbance" (p. 8). As already mentioned above, ASEAN countries may introduce new regulations especially in newly developed financial sub-markets for prudential reasons even if there is no imminent crisis. In contrast, the US proposal accommodates new regulations after the agreement for prudential reasons, but it adds that "such actions shall not

prevent the establishment by financial service provider of another Party of an enterprise for the provision of financial services on conditions which accord national treatment" (p.9). It should be pointed out that the new regulations could include limiting the number of players in newly established sub-markets in order to control the level of competition in those particular sub-markets.

H. Safeguards and Exceptions

The framework agreement should include safeguards to allow ASEAN countries to operate with some flexibility. In the event of severe balance-of-payments crisis, ASEAN countries may temporarily suspend the liberalization process committed under the framework agreement while they sort out the causes of the problem. They may resort to discriminatory measures if there is sufficient evidence to show that the imbalances were caused by excessive activities of foreign financial services providers in host countries. This is in sharp contrast to the US (Article 8) and EC (Article 15) proposals. Safeguards are also necessary to prevent foreign financial services suppliers from practicing predatory pricing in host countries.

VI. INCREASING COMPETITIVENESS OF BANKS IN ASEAN COUNTRIES AND INCREASING THEIR SHARE OF INTERNATIONAL TRADE IN BANKING SERVICES

This section examines some measures that can improve the competitiveness of ASEAN banks and increase their share in international trade in banking services

A. Improving Competitiveness

ASEAN countries have already identified some barriers to competition among banks operating within their own territories. Indeed, there are serious efforts to dismantle these barriers. One of these barriers is the presence of several large state-owned financial institutions in the ASEAN financial markets. The special privileges they enjoy confer them undue advantage over private banks. Although originally designed to be development banks, state-owned banks have gradually moved into areas where private banks are operating. There is now a move towards privatizing most of these state-owned banks while the special privileges given to the remaining ones have been slowly phased out. This process could perhaps be accelerated.

The selective credit control policy of ASEAN countries has undermined the competitiveness of ASEAN banks. It has weakened the initiative of bank managers to manage loan portfolio since a big chunk of it is earmarked to specific priority sectors. The dismantling of this policy, which was already begun by some ASEAN

countries, will hopefully develop more professional bankers in the region.

In the past, policies that encouraged specialization have fragmented the financial markets of ASEAN countries and reduced competition among different types of financial institutions. The recent trend towards universal banking will hopefully increase competition among different types of financial institutions. Fee-based activities have been encouraged. This is important since there is a growing market for fee-based services for both domestic and foreign clients. Experience of ASEAN banks in this area will be extremely useful when they compete in the international financial markets.

Prudential regulations in ASEAN countries have also been revised to reduce instability in their financial systems that might result from stiffer competition. For instance, capital requirements for practically all types of bank categories have been revised upwards. This will encourage small banks to merge among themselves or accept foreign equity participation. Also, rules on loans to bank directors, officers and related interests have been tightened to discourage them from committing fraud. A strong bank that has a good track record at home will be in a better position to enter the international banking community.

Finally, a policy of allowing branches of foreign banks to expand their operations within the territories through branching and to diversify their banking services can further enhance the competitiveness of ASEAN banks. Branches of foreign banks operating in ASEAN countries have served as an impetus for competition. Moreover, they are key sources of banking innovations. This is important to ASEAN countries since there are no patents to innovative banking instruments and services developed by foreign banks.

B. Increasing the Share of International Trade in Banking Services

One of the ways by which ASEAN banks can increase their share of international trade in banking services is through integration of their financial markets. This, of course, requires harmonization of their banking policies. It might be worthwhile to consider this at this moment since ASEAN countries are in the process of liberalizing their financial markets. Joint venture banks could be easily encouraged among ASEAN countries if their banking regulations (and tax systems) are harmonized.

There are already some initiatives being done by ASEAN countries to expand intra-ASEAN banking activities that need to be encouraged further. One is the agreement on using ASEAN currencies in intra-ASEAN trade. It will promote the expansion of trade particularly with ASEAN countries which are confronted

with chronic balance-of-payments deficits or whose traders are covered by tight foreign exchange regulations. More importantly, it will expand intra-ASEAN banking activity arising from greater intra-ASEAN financial flows.

Another initiative, which unfortunately has not yet taken off the ground, is the development of the ASEAN bankers' acceptance (ABA). It is supposed to capture the ASEAN markets on acceptances which have been largely serviced by American and British banks. The ABAs would be eligible only to cover imports of goods from other ASEAN countries. With harmonization of banking regulations and tax system as well as relaxation of foreign exchange regulations among ASEAN countries, progress in the development of ABAs could take place.

It might be feasible for ASEAN banks to create an interbank market among themselves. It was pointed out in Section II that some ASEAN banks are net lenders in the international interbank market, while others are net borrowers. Thus, the potential for developing this market already exists.

Beyond the ASEAN region, it might be necessary for ASEAN banks to participate in some of the activities of established international banks. The country funds that have been recently created for ASEAN countries could have been one of such opportunities. All of these funds are being managed by international banks with practically no participation from ASEAN banks when in fact some of the activities, such as formulation of proposals for client firms, could have been readily done by ASEAN banks.

Finally, the framework agreement on trade in banking services will hopefully give more opportunities for ASEAN banks to increase their physical presence in other countries, especially those that have been their important trading partners. There are strong indications that a multilateral framework agreement will be more beneficial to ASEAN countries as well as other developing countries than a bilateral agreement.

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