

THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Meeting Paper 3-A Regional Financial Architecture

Office of the Advisory Group Chair

PURPOSE

For consideration.

ISSUE

APEC is an entirely appropriate, if under-used, framework for financial system development and reform. Efficient financial systems are a precursor to efficient trade and investment and enhanced economic growth. APEC's voluntary and consensual processes, its established co-operative assistance approach, and its focus on capacity building make it ideally suited to achieving incremental but significant gains. High financial policy is the province of G20 and the IFI's, but making its benefits tangible is a proper, sensible and timely role for APEC.

BACKGROUND

Robust and deep financial systems will allow businesses, small and large, to trade and invest more efficiently across the region. The APEC framework, built on trade and investment facilitation, can now provide further stimulus to regional economic growth through improving the regional financial system – the lifeblood of trade and investment.

PROPOSAL

APEC should endorse and implement a comprehensive multi-year initiative, aimed at enhancing the efficiency and resilience of the financial systems of individual APEC economies and the financial structure and institutions which link those economies. This initiative is in pursuit of the APEC Leaders 2010 Seoul declaration endorsing stronger and deeper regional economic integration.

DECISION POINT

Include the above proposal in the recommendation for APEC to initiate a regional financial framework.

REGIONAL FINANCIAL ARCHITECTURE

“Ask us only to do big things. Governments can only do big things”

*President Hu-Jintao to ABAC members.
Santiago, 2004*

The Proposal

The proposal is that APEC should endorse and implement a comprehensive multi-year initiative, aimed at enhancing the efficiency and resilience of the financial systems of individual APEC economies and the financial structure and institutions which link those economies. This initiative is in pursuit of the APEC Leaders 2010 Seoul declaration endorsing stronger and deeper regional economic integration.

Initially, the initiative would catalogue and analyse financial systems in each APEC economy (the “architecture”) and the systems, institutions and processes that join and support them (the “infrastructure”). Subsequently, the data and analysis would facilitate development priorities and capacity building requirements in the financial systems of individual APEC economies, and the elements to build more robust and efficient financial infrastructure would be identified. Ultimately a number of initiatives and institutional developments may evolve to facilitate measures to improve efficiency, regulation and liquidity support for financial systems on a regional basis.

Rationale

Safe, efficient and comprehensive financial systems facilitate economic growth. To businesses – large and small – the financial system is analogous to the blood stream or the central nervous system; efficiency and reliability are essential for the whole body of the economy to function effectively.

For policy makers comprehensive and deep financial markets enhance resource allocation and mediate capital flows. Improved macroeconomic management is possible through the monetary transmission mechanism.

In all the regional economies living standards are rising. It is in the interests of all the citizens of these economies that their savings are used efficiently. As their specific financial requirements grow along with their living standards, they require appropriate institutions and structures to provide financing for housing, infrastructure, health and pensions.

Growing trade and investment flows increase linkages between each economy and, as the recent financial crisis has demonstrated, also expose points of stress and weaknesses. These issues may sometimes be dealt with by strengthening individual economies, but increasingly the focus needs to be system wide.

Scope

The initiative would catalogue the present APEC financial systems in a structured format. Some systems are obviously very complex – the USA for example – but much data exists for both the formal and “shadow” systems across the region. The first order objective of the initiative would be to assist domestic policy makers in deciding objectives, priorities and sequencing for financial market development and reform. The approach would identify capacity constraints and identify the APEC economies with relevant experience and resources to assist capacity building.

Regional financial links would also be made transparent by the initiative, and appropriate responses could be devised and implemented. Settlement risk exists across the region as settlement between local currencies and the US dollar – commonly used for trade and investment – is not “payment-versus-payment”. Custody risks also exist as securities are generally held in costly tiered systems.

An initiative of this scope would need to be carefully structured over a multi year period. Much of the data already exists and much of the “high” policy analysis has already been done, by the IFI’s, or will emerge from the new responsibilities of the G20. The existing regional architecture has already provided the Asian Bond Market Initiative – through ASEAN, EMEAP and APEC – and the Chiang Mai Initiative. APEC now has a Policy Support Unit to assist in this type of initiative.

The initiative now proposed responds, in several ways, to the Finance Ministers endorsement of the objective of developing broader and deeper capital markets. It would use the established

APEC voluntary and consensual approach to technical assistance and to capacity building within economies to assist the development of more efficient and comprehensive financial markets and systems. It would recognize the linkages between the individual economies and provide a regional approach to strengthening the financial infrastructure. It may ultimately lead to the development of institutions to deal with regional stability issues, along the lines of an expanded Chiang Mai Initiative, or with regulatory or other issues of particular concern to the region.

The impetus to sustain a multi year effort would be the obvious self interest of each economy in improving efficiency and resilience, motivated also by peer pressure from business and consumer interests with access to the comprehensive region-wide catalogue. This would assist policy makers interested in reform, who often complain about lack of support from business and consumer groups.

Conclusion

Robust and deep financial systems will allow businesses, small and large, to trade and invest more efficiently across the region. The APEC framework, built on trade and investment facilitation, can now provide further stimulus to regional economic growth through improving the regional financial system – the lifeblood of trade and investment.

APEC is an entirely appropriate, if under-used, framework for financial system development and reform. Efficient financial systems are a precursor to efficient trade and investment and enhanced economic growth. APEC's voluntary and consensual processes, its established co-operative assistance approach, and its focus on capacity building make it ideally suited to achieving incremental but significant gains. High financial policy is the province of G20 and the IFI's, but making its benefits tangible is a proper, sensible and timely role for APEC.