4. Economic Consequences of the Asian Financial Crisis, Post-crisis Challenges and Responsibilities of Central Banks

Khee-Giap Tan*

I. Introductory Notes: Coping with Rapid Growth, Volatile Fund Flows and Internet Driven-Online Financial Services

After decades of rapid economic growth averaging 6% to 9% per annum for emerging economies of East-Asia throughout the 1980’s and 1990’s, it has become apparent that the high efficiency of their export-driven manufacturing sector is not matched by the increasingly internationalized financial sector (see Tan 1997). It is also quite clear that the malignancy of Asian financial turmoil comes from the twin crises - that is referring to the capital account shortfall coupled with domestic credit contraction (see Yoshitomi and Ohno 1999). The vulnerable inefficient banking system was further typified and exacerbated by the double mismatches – which is now widely known as the currency and maturity mismatches. It is

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widely acknowledged that the Asian Financial Crisis (AFC), which begun in July 1997 and affected the regional economies for approximately 36 months in terms of economic growth, was essentially private sector-induced. However, we are of the view that the respective central banks clearly should be held responsible for the imbalance-growth between the real and financial sectors as well as the ensuing systemic-wide financial instability (see Kariyane, Tan and Yuwahama 2000).

In retrospect, further debate on causes of the AFC has no doubt been reduced to academic interest to be included in the textbooks for future students. More seriously for some economies, the inflicted social costs and their wider implications to the population at large will continue on for many years to come. It is therefore more meaningful to deal with post crisis measures and reform lessons that could avoid if not prevent another AFC. It would be foolish to believe that the current recovery of the Asian economies would be sustainable if resolution for tough policy reform programs begins to waiver by the earlier-than-expected swift regional economic rebound as shown in Table 1.

The post-crisis challenges for central banks must be to ensure balanced-sustainable economic growth, enforce effective supervision on financial institutions and adequately cope with internationalized fund flows resulted from Internet technology and globalization. Prior to the recent financial turmoil, many Asian countries and economies aspire to be amongst the major financial centers notwithstanding the obvious economy of scale on financial activities and duplication on financial services. To put it mildly, most Asian national leaders were impatient, careless and complacent. Robust economic expansion carries with it rapid capital flows, leaving many of their financial institutions over exposed and exerting on the relatively less matured financial systems more stress than they can bear. Healthy foreign exchange reserves accumulated over the decades were decimated in a few months or weeks. Weaknesses and instability of regional financial system were revealed following the ensuing currency turmoil and volatile capital mobility, even established financial centers such as Hong Kong and Singapore which have relatively strong economic fundamentals are not spared.

The Web took off in the middle of 1990’s and Internet driven-online financial services or electronic banking (e-banking) soon gravitates around it to develop into a new phenomenon. The impact of increasing Internet usage on financial services is going through an evolutionary
process but at a revolutionary pace. In April 1995, Security Network Bank became the first true online bank running on the Virtual Branch with no brick-and-mortar presence at all, and by June 1996, Huntington Web Bank, another full-service Internet bank, came in to service in the United States. Europe’s first Internet-only bank, e.first.com, opened only as recent as the early October 1999. In Asia, we have seen a few Internet-only banks being established in Singapore in early 2000 and recently Hong Kong Monetary Authority threatened to remove from the Hong Kong web side foreign Internet banks which have been accepting Internet deposits but are yet to be registered with the local authority. However, to many banking communities in Asia, Internet banking is still very much in a conceptual stage.

Table 1  Real Gross Domestic Product (GDP) of Selected Countries

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<td>119.1</td>
<td>126.1</td>
<td>131.1</td>
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</table>

* Preliminary estimates for 1999 and 2000 are projected by ASEAN Economies Monitoring Unit (AEMU) at Nanyang Technological University, Singapore. Data from 1992 to 1998 are extracted from International Financial Statistics, IMF, Asian Development Outlook, ADB.
Although private sector ought to be in the driving seat in this information driven evolution, but governments inevitably must take the lead in facilitating the growth of the Asia information infrastructure as we gravitate towards a knowledge-based economy. The Asian currency turmoil, which had led to economic crisis and financial paralysis, will further exacerbate the economic burden in the move towards e-banking. For countries with geographical diversity and unbalance regional development, e-banking if not properly planned and managed may lead to further income disparity known as digital divide. For Asian economies with rudimentary financial system and institutions, amongst the biggest challenges are ensuring public confidence in the security of Internet banking and mitigating risks through a comprehensive set of Internet-specific laws which are still in its infancy stage with many legal and tax issues unanswered. In this regard, central banks in East Asia would have a daunting task to supervise such virtual banks across borders in uncharted water.

II. Some Observations and Policy Implications for Regional Central Banks and Financial Centers

Almost three years through the currency turmoil, policy contradictions and retrogressive moves are beginning to manifest amongst regional financial centers whilst central banks fight hard to preserve their aspirations. Firstly, market competition may now be tempered with more regulations. Secondly, international financial activities may now be confronted with interventionist authorities. Thirdly, market efficiency is beginning to be hampered by restraint on information flows and transparency. Fourthly, accessibility to financial markets may now be delayed as momentum for greater opening slows down under the name of prudence and stability (see Lee and Tan 1999).
1. Restoring Banking Stability: Beyond Supervised Capital Requirements

Towards the near aftermath of the currency turmoil, one may begin to question the inadequacy of the capital-adequacy ratio set by Bank for International Settlements (BIS) which was applied to banks across the board in all member countries and economies. Retrospectively, capital-adequacy ratio is a blunt measure to manage bank risks since it does not take into account of credit risks, portfolio risks and value-at-risk estimates. However, technically there is a lack of consensus as to how such risks can be factored into an objective calculation and given the general difficulties in its implementation even if such formulae can be arrived at (see Federal Reserve Bank of New York 1998).

In the light of these mounting difficulties, there are numerous calls to erect yet more international institutions for reducing global financial instability such as a World Monetary Authority, an International Federal Deposit Insurance Corporation, a Global Financial Regulator, an International Bankruptcy Court, an International Financial Crisis Manager, a “Deep Pockets” International Lender of Last Resort etc (see Rogoff 1999). However, we propose a regional approach towards core principles for effective banking supervision, which are consistent with the Basle Initiatives 2000. Such regional initiatives that involve in particular proper supervisory agency, capital regulations, criteria for licensing banks, lending procedures, information-reporting systems, risk management profiles, accounting standard, timely corrective actions, consolidation and co-operations amongst banks. Since these are rather crucial yet sensitive core principles to be upheld, the regional approach can begin from East-Asia or even within ASEAN.

Caprio and Honohan (1999) argue that the underlying causes of banking problems in developing countries go beyond supervised capital requirements. Bad banking practices and political interference were identified as underlying sources of weakness. The best prudential safeguard is early surveillance, greater disclosure and reinforcements for monitoring banks. One suggestion that comes out of the global concern for the fluid activities of hedge funds is to monitor through the risk profile of banks, coupled with voluntary surveillance system as early warning signals on the health of financial intermediaries. However, given that there exists no standard definition to date on hedge funds, it is indeed
quite difficult to legislate and implement rules to regulate them. The gathering of Group of 22, International Monetary Fund and BIS are likely to take time to come up with a new prudential requirements. Therefore it is of crucial interest and especially to the affected economies which are beginning to recover to come up with their respective national initiatives on disclosure standards with greater accountability and transparency.

2. Enhancing Bank Disclosure, Public Accountability and Supervisory Transparency

With this shift in emphasis worldwide for central banks in mature economies to move supervision to regulation, the *sin quo non* for this shift must be greater transparency and higher disclosure standard, in particular when banks are constantly under international surveillance within the globalize financial markets (see Mishkin 1999). According to the recent report by the Committee on Banking Disclosure (1998), an international comparative analysis revealed that the United States and the United Kingdom are leading the best financial disclosure practices followed by the European counterparts such as Germany, Luxembourg and Switzerland. Australia, Japan, Singapore and Hong Kong are grouped under the third category for benchmarking within the Asia-pacific region. The Committee on Banking Disclosure had made several recommendations which encompass undisclosed reserves, accounting policies, profit and loss account, balance sheet coverage on assets, liabilities and shareholders’ equity, off-balance sheet, supplementary information, financial review, equity accounting and reporting requirements.

One of the policy mistakes that many central banks committed during the early stage of the currency turmoil is the failed attempt to shore up their local currency value through market intervention which quickly depleted the precious and much needed foreign exchange reserves. Central banking discipline and public accountability can and should be reinstated or strengthen further by setting up a separate government supervised investment company to better manage foreign reserves based on optimal long term yields. Leaving the central bank with only working capital to “smooth” the shorter-term exchange rate fluctuation under a preferred option of a basket of trade-weighted-managed float exchange regime. In 1999, Mr. Allan Greenspan,
Chairman of the Federal Reserve Bank of the United States, called for greater transparency and accountability in the management of foreign exchange reserves especially for those export-oriented surplus economies of East Asia.

The argument that ultimate control on central banking discipline and public accountability may still lie with the quality of government is well taken. However, setting aside the accumulated reserves on longer-term investment portfolio may make it at least administratively less fluid for easy and non-transparent decision to be made without public accountability. In the event of temptation to easy option or unjust monetary policy being adopted by the central bank, investment in longer-term bonds or positions in the less liquid property investment may discourage temptation to easy policy options.

3. Coping with Capital Flows, Guarding Against Market Manipulation and Maintaining Exchange Rate Stability

Reasons for capital flows are due mainly to changes in economic fundamentals, market imperfections and official policies, and in recent years the active financial innovations and growth of the hedge fund industry within an increasingly integrated global financial community. Effective supervision on international financial intermediation is amongst one of the biggest challenges to central banks. Capital controls are unlikely to eliminate completely capital flows although these rules are amongst the most important impediments to market accessibility. Very often capital controls are further reinforced by barrier to entry set on foreign financial intermediaries either in terms of ownership, taxation or financial participation.

A comprehensive capital controls would enable the local economy to be insulated from global monetary market forces such as interest rate and exchange rate influences. Hence countries are able to pursuit independent monetary or/and fiscal policies in relative isolation from external developments. In the light of the recent currency turmoil, resistance to capital controls has been softening following the Chilean and Malaysian experiences and policy sentiments for greater financial market openness have also been weakened considerably at least in the
short run. Speedy transmission of external financial shocks and contagious systemic consequences are often cited as justification for controls. According to Fisher and Reisen (1993) and recent studies by Edward (1999) provide a thorough account of country experiences on capital and exchange controls, which they concluded to be largely ineffective.

Our recent empirical studies on capital flows of ASEAN-5 over the 1990’s have shown that, following the classification investment fund flows by the International Monetary Fund, both direct investment and portfolio investment are found to be less volatile as compared to other investment, which largely consist of inter-bank borrowing and lending. The implication of such empirical results is that even if capital controls are effective, it is in fact unnecessary since restricted usage of local currency by non-residents or a policy now known as the non-internationalization of the local currency may be sufficient to capture the volatile movement of other investment. Yet such a policy still ensure free flow of capital and market determination of exchange rate value (see Lee and Tan 1999).

One of the important system features that appears to have exacerbated the Asian currency turmoil must be the rigidity of the foreign exchange regime that were virtually linked to the US dollar as were the case of Thailand, Indonesia and Malaysia, and to a certain extend Philippines and Singapore too. When confronted with the volatile capital mobility specifically that of the “hot money”, most market-oriented economies of ASEAN were seriously impaired and saw their currency strength heavily battered except Singapore as seen in Table 2.

<table>
<thead>
<tr>
<th>Table 2</th>
<th>Economic Growth and Currency Depreciation*</th>
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<tr>
<td></td>
<td>1998 GDP Growth</td>
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<tr>
<td>Indonesia</td>
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<tr>
<td>Thailand</td>
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<td>Philippine</td>
<td>-0.5%</td>
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<tr>
<td>Singapore</td>
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* Refers to the worst currency value lost since the currency turmoil.
For an outward export-oriented economy, adoption of a trade-weighted basket managed-float exchange rate regime may be a more market-determined system. Under such a regime, a reasonable level of foreign exchange reserves often valued to be worth several months of imports may well be a prerequisite to exchange rate “smoothing”. The essence of the managed-float exchange rate regime is to allow the value of the local currency to “float” with market forces vis-à-vis the currencies of trading partners and the central bank only comes in to “smooth” the exchange rate whenever volatile movements occur.

Non-internationalization of the local currency could turn out to be the most significant policy safeguard to financial stability if the managed-float exchange rate regime is to be effectively “smooth”. Regulatory measures to ensure non-internationalization of the local currency must be in place and monitor closely. Such policy is of particular relevant to an emerging economy whose exchange rate movements may be intimately linked to the rate and the stage of the economic development. Under the non-internationalization policy, flows of capital may not be hindered but restrictive usage of local currency to non-residents and its circulation beyond the national geographical boundary is to be disallowed. As the economy matures and its size expands, gradual internationalization of the local currency can then slowly be introduced as governed by the degree of openness to trade and flows of foreign direct investment.

Those advocate for sequencing of stabilization and structural reforms advise delaying dismantling of capital controls for fear of capital inflows and swift real appreciation of exchange rate, thus remove protection for tradable sector. Capital controls therefore should be retained when an economy is undergoing major stabilization and liberalization reforms to avoid sudden attempt for foreigners to increase their claims on the reformed economy. However, some quarters strongly argue that capital account liberalization should be sequence first to reduce structural adjustment costs by relying on foreign capital during transition. Early capital account liberalization may serve to expedite reform plans and avoid vested interests and political constraints that are resisting reform.

Under the political economy of liberalization thesis, the disillusionment about the effectiveness of capital controls justified dismantling of controls. Growing trade integration and the increased presence of multinational corporations produce closer financial links and
opening up ways for circumventing existing controls. The imposition of
capital controls can generate uncertainty about further tightening and thus
stem capital inflows and induce capital outflows. Those who questioned
the effectiveness of capital controls generally suspect that controls often
become another convenience or the most attractive channel for corruption

4. Inconsistent Policy Targets and Retrogressive
    Measures by Central Banking Authorities

    Bank Negara Malaysia’s (BNM) approach to cope with capital
flows depicts a classic case of policy contradiction in her handling of
excessive capital inflows in the early 1990’s and volatile capital outflows
in the late 1990’s. Although BNM’s approach to deal with the two
separate situations was understandably dissimilar, however the policy
outcomes in both cases are actually the same. The adopted approaches
can be termed as policy over-killed since BNM’s extreme measures had
led to swift withdrawal of funds which tends to exacerbate and destabilize
the precarious financial markets (see Tan and Cheng 1995; Tan 1998).

    The occurrence of unprecedented events soon after the Hong
Kong’s historic July 1997 reversion to China should not be viewed as a
series of random events but instead should be taken seriously as signals to
further fine tune or correct the weaknesses of the system. We should not
ignore Hong Kong’s structural shift in manufacturing activities which has
taken place since the middle of the 1980’s and the apparent vulnerability
of her financial system to speculative attacks in the midst of the Asian
currency turmoil. Hong Kong Monetary Authority’s (HKMA) action and
justification to directly intervene in the financial markets against the
speculative attacks may be viewed as an indication of some potentially
serious structural imperfection on Hong Kong as a financial center (see
Tan 1998).

    Economies that are vulnerable and exposed to the currency turmoil
may resort to immediate actions to safe guards their own national
interests before further damages are being inflicted. So HKMA had
decided to move in on massive unprecedented market interventions while
BNM had opted to cut Malaysia off from the international monetary
system through exchange controls and other related rules. However, the
important point to note is that such inconsistent policies or retrogressive
measures by central banks are costly and should be avoided. In retrospect,
both HKMA and BNM concluded that elements of manipulation exacerbated the crises, and effective banking supervision would have mitigated somewhat the degree of financial instability in both cases if only central banking authorities possessed more information on financial intermediation processes.

5. Policy Over-Spill, Contagion Effect and Regional Central Banking Coordination

One of the clear lessons which have emerged from the currency turmoil being that central banks in fast growing economies probably have to include assets inflation explicitly as amongst the central banking policy objectives as Monetary Authority of Singapore had already done since 1995. The other experience that came out strongly through the currency crisis is the pursuing of unsustainable growth policy which led to macro economic imbalances tend to attract excessive capital inflows or/and volatile capital outflows. Indeed Blinder (1997) discusses on what central bankers could learn from academics and vice versa.

Sudden policy measures by the central banking authority of the affected country may have the over-spilling effect to the neighboring economies as capital mobility intensifies. A case in point would be the strong measure of imposing reserve cost on the vostro ringgit account in by BNM in the early 1990’s had led to excessive capital outflows seeking sanctuary in the Singapore markets. Similarly, in the Singapore markets, the excessive short speculation on ringgit by foreign exchange dealers coupled with rumors on the impending imposition of exchange controls had resulted in the extremely high shorter-term interest rates on the Malaysian currency. Such financial activities and interest rate differential in turn had exacerbated the exodus of ringgit deposits from Malaysia thus causing domestic fund shortages. These are circumstances that policy coordination clearly exists amongst central banks. It is therefore paramount and pertinent for policy authorities to be careful so as not to create economic conditions and political environment that tend to attract financial speculations.

The global banking industry has gone through a series of lending excesses over the past three decades which include the international bad debts of the 1970’s, energy and real estate crisis of the 1980’s and Asian emerging markets of the 1990’s. For the year 2000 and beyond or the new Millennium, ways are cleared to erase financial barriers in creation of financial supermarkets. This significant US financial sector reform is supposed to lead to major improvements in financial services, promote financial innovations, lower capital costs, greater variety of financial products for consumers and strengthen international competitiveness. Historic legislation looks set to be passed soon by US law makers to repeal the 1933 Glass-Steagall Act and the 1956 Bank Holding Company Act.

Intensified competition worldwide had led to a series of mergers and acquisitions (M&A) which begun in US and subsequently took place amongst European and Japanese banks. The Financial Service Modernization Act of 1999 would set the train of M&A moving across bank and non-bank financial institutions and produces vast service-based conglomerates. The major rationales for M&A are essentially due to over capacity, to realize costs saving, greater business synergies, allowing cross selling of services and of paramount importance, Web-based Internet technology-driven consolidation.

Over capacity in the banking industry leads to lowering of lending criteria, irrational pricing of credits which can weaken the financial system. M&G will therefore necessarily mean substantial loss of jobs at least in the shorter-term, further investment and super-heading the new technology advancement, responding to demand for specialists in newer businesses under a new competitive environment and coping with the mammoth task of business consolidation and management restructuring. From the investors or consumers’ perspective, intensified competition had led to increasing emphasis for high growth/high yield instruments. Given the Asian economic crisis and financial paralysis, the global interest rate environment has remained benign. Greater financial deregulation worldwide and freer flows of financial information enhance financial innovations and cross-border financial investments.

Notwithstanding the Asian currency turmoil whose recovery momentum and strength are faster than expectation, wealth accumulation in Asia after prolonged years of growth have significantly changed investors’ expectation towards the returns of Western traditional pension
funds. In meeting these more sophisticated demand by the new high net-worth Asian individuals, commercials banks are shifting their traditional financial intermediation of deposits taking-corporate lending businesses emphasis to investment portfolios, fund managing and private banking. Hence we saw the rapid growth of “target” funds, boutique fund managers and private banking facelift with very tailored-made structured financial products to cater for individual investor’s requirements and expectations (see also Lee 1999, 2000).

Such changing landscape in the global banking industry is changing the approach in which central bankers think about supervision in view of the worldwide trends of convergence amongst financial institutions and blurring of product boundaries. It is therefore rather logical to look into the model of an omnibus Act to streamline and consolidate the existing supervisory role and regulating structure and financial services legislation which is deemed to be more cost effective and prevent regulatory arbitrage. Examples of possible changes include a single authorization or license for all financial institutions and a bottom-up approach where capital is required for different regulated activities within a financial institution (see Koh 2000).

7. Potential of Online Financial Services and its Implications for Regulating Authorities

As the demarcating lines between bank and non-bank financial institutions such as securities firms and insurance companies are blurring, competition and market encroaching from non-bank financial institutions, which are also strong branded market players, to commercial banks in terms of the traditional financial intermediation are intensifying. Web-based Online financial services (OFS) with Virtual Branch and specialist services outsourcing such as mortgage processing companies are becoming new marketing and sales channels where contracting or closure of brick-and-mortar branch network are to be expected (see Tan 1999).

According to the 1999 annual survey on Asian CEO issued by the World Economic Forum and Price water house Coopers revealed that half of the respondents believe that the financial industry will be most significantly impacted by the Internet over the next two years. About 42% of the respondents, as compared to 35% in 1998, do not rule out government regulation of Internet of some kind. In 65% of the Asian
CEOs, as compared to 70% last year, agree that Internet access, transaction and use should not be taxed. No doubt the potential of e-banking is written on the wall, however, the two issues concerning government regulations and imposition of taxes on Internet activities are rather controversial and debatable which we shall revisit later. It is hardly surprising that CEOs, financial experts and policy makers are basically upbeat or at times even over anticipatory about the potential of OFS.

### Table 3 Projected Internet users in Asia Pacific*

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<td>0.13</td>
<td>0.19</td>
<td>0.29</td>
<td>0.20</td>
<td>72</td>
</tr>
<tr>
<td>USA</td>
<td>56</td>
<td>70</td>
<td>87</td>
<td>109</td>
<td>138</td>
<td>31.64</td>
<td>275</td>
</tr>
</tbody>
</table>

Note: * Internet users in millions as projected by International Data Corporation  
** Projected Internet users as a percentage of the population  
*** Population as at the year 2000 as projected by PECC

If we just look at table 3 indicating the exponential growth of the Internet users worldwide since the middle of 1990’s, it is indeed a business phenomenon that we have not witnessed or encountered.

The filtering of Internet banking through to main stream commercial banking is a fairy new phenomenon. Amongst the top ten banks from the United States, Wells Fargo Bank began to provide full range internet-based on-line banking services in 1995, followed by First
Union Bank and Bank of America in 1996 and Citicorp and Banc One as recent as 1997. Surprisingly until 1998, major financial institutions such as JP Morgan, Bankers Trust, Chase and First Chicago CND are yet to move into this new medium of financial services. In late September 1999, for the first time ever, a revolution in institutional financial management called CFOWeb.com was launched in the United States. It is an international network created exclusively for chief financial officers, treasurers and fund managers which provide direct access to international capital markets with more choices, increased resources and lower costs than were ever before possible. CFOsWeb.com offers a complete array of innovative online tools and services that let you manage your portfolios, determine fair market valuations, process a trade or satisfy FASB and regulatory reporting requirements, all in Internet time.

In Asia, Hong Kong and Singapore are amongst the leaders in the provision of OFS. According to the Hong Kong Monetary Authority, as of October 1999, there are already five banks in Hong Kong providing Internet banking (i.e. Heng Seng Bank, Citicorp, East Asia Bank, Wing Long Bank and Tao Hang Bank) although not all five are involved in full range Internet-based on-line services). Twelve banks are currently planning to launch financial services through Internet and twenty banks have expressed interest to participate in such a new medium. In Singapore, OFS including commercial banking, securities brokerage services and insurance services have been gaining momentum over the recent years. On Internet banking, almost all the major local banks and securities firms (such as Development Bank of Singapore, Overseas Chinese Banking Corporation, United Overseas Bank, Overseas Union Bank and Keeper Tattle Bank) and most foreign full license banks (such as CITIBank and AMRO Bank) are already involved in Internet banking. Malaysia, India, Indonesia and Vietnam have at least one major bank already tapping the Internet to offer financial services, Philippines will follow suit shortly.

For effective banking supervision, the central banking authorities ought to seriously take into account the following reality and impact of e-banking:

The America Banking Association estimated in 1996 that an online financial transaction cost $.01, an ATM transaction costs $.27, a telephone transaction costs $.54 and a branch transaction costs $1.07. Although duplication of delivery or access channels may actually
increase costs at least in the short run. Justifying Internet development based on short term cost saving may be unrealistic since changing of consumers’ habit may take time. There will be a fundamental shift of power to consumers through information accessibility.

Embracing Internet could destroy basic business and pricing model since it reduces barrier and moves closer to perfect competition. Cannibalization of existing businesses such as the traditional brokerage services is to be expected. Use of physical cash is unlikely to disappear and face-to-face approach to banking services will continue for quite some time.

Low confidence in terms of data confidentiality, system security and lack of legal precedent, unclear tax treatment to financial transactions and trading in uncharted territory may discourage participation. Shifting from branded financial products or services to information based banking. Disintermediation of traditional roles and channels would take place and rapid advances in technology may render correct infrastructure investment obsolete

On foundation building in the longer term, the biggest challenge within the knowledge based information society for any economy is still to educate and upgrade the profile of the population workforce which is an expensive long term process and need carefully thought out strategies. Although building of physical information infrastructure for wealthy nation in theory can be done in a single stroke, such move would be unwise if Internet-specific laws, provision on data security, intellectual property rights and privacy policy are not being considered simultaneously.

On managing changes during the transition, incremental up-grading or the evolution pace towards establishing a comprehensive Electronic Data Interchange would lead to smooth leap for more advance information infrastructure. A consistent government initiated regulatory institution would be needed to push through certain sub-sectors where market forces are weak to ensure general accessibility and affordable access

On mapping future strategies to maintain a competitive edge, rapid advances in the Internet technology calls for convergence of telecommunication, media and information technology sectors. Forming of an international advisory group to super-head strategic information
infrastructure planning and identification of market stimulants would be paramount. Individual government, taking into account of the social and cultural aspects, may wish to decide subjectively the degree of liberalism that would be allowed to be filtered through by way of “Internet censorship”.

8. Competitive and Efficient Financial Center Based on the Principle of Comparative Advantage

Rationales and incentives for countries and economies to push and promote growth of financial centers are obvious. An international financial center contributes not just to her local economy but also facilitates the financial intermediation of economies surrounding it. A financial center supports and services her local economy through a variety of channels. A financial center which plays the funding role of inwards financial intermediation helps to pool savings, integrates capital markets, create employment opportunities in all related sectors. It also facilitates cross-border trade and foreign direct investment, supporting economic activities across sectors and serves as a reliable framework for the conduct of monetary and fiscal policies. As in the case of both Hong Kong and Singapore, financial sector is an important source and engine of growth.

In the midst of eagerness to promote financial center, it is often not fully appreciated that establishment of a successful center not only needs to be timely, it is also costly and requires continuing and long-term effort. Deliberate effort to set up a financial center can be a very costly exercise since financial infrastructure encompasses more than just physical buildings and sophisticated telecommunication facilities as some failed financial centers soon realized. It must first be situated at a geographical location and time zone that would fill the gap in international trading hours and serve the needs of regional economies. It entails also an internationally recognized accounting standard and legal system. It calls for a strong local economy with a stable currency. It presumes a harmonious political environment with effective government. It should be served with international airport plus accommodation facilities for mobility and comfort. It demands a quality workforce with English as the lingua franca.
It is now widely accepted that economy of scale exists in the provision of financial services, however it is not widely recognized that duplication of financial services prevails in the Asian region. Thus the viability of an efficient financial center to cater for the need of regional economies must be ground out based on the principle of comparative advantage through market pricing mechanism and level playing field competition. Governments directed resources to promote financial centers and fasten the pace of financial liberalization, it is often being overlooked that speedy capital growth through non-market oriented promotions such as pre-approved loans, directed lending, non-competitive-priced borrowings and non-market evaluation assets are simply the sure recipe for market instability and financial paralysis.

Therefore despite the currency turmoil, financial liberalization per se is still a fine concept for efficiency enhancement. It is the haste and the non-market approach in which this liberalization process is being brought about, effective banking supervision tends to be compromised. In the era of booming growth since the 1980’s, contesting financial centers include Bangkok, Hong Kong, Jakarta, Kuala Lumpur, Manila, Singapore, Sydney, Taipei and Tokyo. Assuming Asian’s long term growth prospect is still intact and we believe important empirical issues remains at to how many major financial centers are sustainable in East Asia? The process in which these financial centers emerge and take shape will be most interesting.

III. Concluding Remarks: Some Lessons and Suggestions

Some useful lessons to be reminded are as follows: Firstly, it is quite clear that to curb financial activities directly will be a costly process and direct massive intervention in the market place tends to cause distortion. It may be more efficient and less arbitrary to seek for a resilient financial structure to better deal with capital flows. Secondly, instead of trying to fend off excessive capital inflows or outflows, it may be more pertinent for policy authorities to ensure that economic conditions and political environment are not created to attract excessive inflows or exacerbate volatile outflows. Thirdly, while waiting for international monetary
reforms to take shape, individual economy should seek initiatives to buffer their own system by working within the requirements of the international financial community and global monetary order.

Finally, we should be more careful about the formulation of strategy and direction of resources by regional authorities to promote growth of financial centers. Policy authorities should only explore and compete based on comparative advantages of the respective economies in Asia instead of pursuing policies of unwarranted duplication under the polite pretext of complementarily. To put it mildly, for Asian economies that have been careless and complacent over the years, it may be time to review the effectiveness of checks and balances for excesses within the government. Instead of concerning too much or complaining against what could well be the dynamic behaviors and consequences of a more integrated market pricing mechanism, the phenomenon may just be the new global financial order that we all must learn to live with. Of course effort to ensure non-interruption of steady global growth must continue and pressure to reform the world trading system and international financial order is an on-going process.

In the light of the currency turmoil, the proposed structural reform to dichotomize the financial system between on-shore and off-shore activities, the suggested non-internationalization of local currency to better cope with capital mobility, privatization of foreign reserve management to ensure efficiency and accountability, adoption of a trade weighted managed float-exchange rate regime to smooth volatility, sub-classification of capital-adequacy ratio to reflect quality of bank assets, central banking policy coordination among regional economies to minimize spill-over effect and broadening the objectives of central banks to encompass asset inflation are some of the ideas worth considering. A regional initiative towards core principles for effective banking supervision consistent with Basle Initiatives 2000 may be a more realistic and efficient way of pushing ahead.

Retrospectively, if there is any lesson to be learnt by the International Monetary Fund, as admitted by it’s managing director Dr. Stanley Fischer, failure to appropriately judge members’ readiness prior to the advice on capital account liberalization is a serious policy oversight. Weak financial institutions and rudimentary financial system can only evolve through a gradual process of financial liberalization consistent with economic development. Effective mobilization of domestic savings
through extensive network of financial intermediaries may be an important source of funding for investment projects.

Given the recent trends of convergence within the global banking industry, for efficiency and streamlining of regulation, an Omnibus Act for all financial institutions may be the inevitable way forward. The ongoing developments of Internet driven online financial services do pose serious challenges to central banking authorities in terms of effective banking supervision. The more fruitful approach is perhaps not to attempt to regulate or control these activities but we should allow the market to dictate instead. However, to effective monitoring their impact on financial services and financial institutions would call for a more comprehensive financial information system. In this sense we may concur with some market observers that "it is a fallacy to speak of the wisdom of the market place" at all times especially where efficiency of the market place prevails through regulations and institutions set up by the international policy authorities and financial agencies.

References


