Challenges for the Financial Systems of ASEAN Countries and Multilateral and National Policies
—Implications for Japan as It Aims to Enhance Its Status as an International Financial Center—

By Satoshi Shimizu
(shimizu.satoshi@jri.co.jp)
Senior Economist
Economics Department

Summary

1. After the Asian financial crisis of 1997, ASEAN countries worked to improve their financial sectors, resulting in significant development of the sectors. Cooperation and coordination initiatives such as ASEAN+3 regional financial cooperation have played a part in this process. Japan has been making its presence felt in these initiatives since immediately after the Asian financial crisis. In addition to continuing its involvement in these initiatives, Japan should continue to focus on strengthening its relations with ASEAN countries, also in the context of working on its own financial sector policies.

2. Challenges for the financial sectors in ASEAN countries include 1) financial system development, 2) regional financial integration, 3) financial stability, 4) financial inclusion, 5) infrastructure finance, 6) climate finance, and 7) digitalization of finance. Various organizations are tackling these challenges, including through regional financial cooperation.

3. Regional financial integration refers chiefly to 1) financial services liberalization (expansion of cross-border activities by banks and other financial institutions), 2) capital market development and integration, 3) integration of payment and settlement systems, 4) significant capital account liberalization, 5) internationalization of regional currencies (cross-border use), and 6) harmonization of regulations and systems within the region. Financial system integration will not be easy, making it necessary to discuss practical measures to promote integration at the level of the real economy.

4. While Japan has also focused on bilateral financial cooperation, it will be important for it to continue to provide experience, knowledge, and technology to meet the needs of partner countries. In Malaysia, where the population is graying, there seems to be room for Japan, which is ahead of the curve in terms of population aging, to supply know-how in various areas. And in Thailand, too, there is probably potential for cooperation in areas such as sustainability, digitalization, and financial inclusion. In other ASEAN countries (except Singapore), there is still a need for more basic financial system development.

5. The success of Singapore's policy of becoming an international financial center is due to 1) a focus on the development of foreign exchange markets and asset management sector, 2) the crafting of a long-term vision, and 3) joint creation of policies by industry, government, and academia. The reputation of Singapore as an international financial center has been improving until today.

6. Japan must solidify its role in regional financial cooperation frameworks such as ASEAN+3, in ASEAN financial integration, and in bilateral financial cooperation. Japan is aiming to elevate its status as an international financial center and beef up its asset management sector (establish itself as a leading asset management center), and in all these policies, it also needs to emphasize the reinforcement of relations with ASEAN countries and to strive for coexistence with them. Strengthening financial ties with ASEAN countries is important in many meanings. The hope is for an expansion of effective initiatives in the future.

Introduction

Developing and supervising their financial sectors is a key role for national governments. In emerging economies, in particular, the financial sectors remain immature, so improving them presents a challenge. After the Asian financial crisis of 1997, countries in the region, and especially ASEAN countries, worked to tackle the issues with their financial sectors, resulting in significant development of the sectors. Cooperation and coordination initiatives such as regional financial cooperation based on the ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting have played a part in this process.

In this paper, I review current efforts in regional financial cooperation and regional financial integration, as well as the financial sector development policies of the governments of each country, and summarize the challenges faced by the financial sectors of ASEAN countries. In light of my findings from that review, I then consider the kinds of action that should be taken at the multilateral and national levels going forward.

Notably, Japan has played a major role in multilateral and bilateral financial cooperation since the immediate aftermath of the Asian financial crisis. Japan should continue to focus on deepening its relations with ASEAN countries. Japan aims to enhance its status as an international financial center, and its relations with ASEAN countries will also be important in this effort.

In addition, Singapore is continuing to elevate its status as an international financial center. It can thus serve as a reference for Japan, so I also examine in detail Singapore's financial sector policies.

The structure of this paper is as follows: 1. summary and overview of the current challenges facing the financial sectors of ASEAN countries based on past financial cooperation initiatives, 2. description and assessment of the current status of multilateral initiatives such as ASEAN+3 regional financial cooperation, 3. explanation of developments in ASEAN financial integration and examination of regional financial integration from various perspectives, 4. brief discussion of each country's financial sector policies and methods of supporting them, 5. detailed analysis of financial sector policies in Singapore, which has continued to enhance its status as an international financial center, and 6. discussion of Japan's financial sector policy and the need to deepen relations with ASEAN countries.

1. Overview of Current Challenges Facing the Financial Sectors of ASEAN Countries

(1) ASEAN+3 Regional Financial Cooperation

To begin with, I will consider the challenges facing the financial sectors in ASEAN countries from the perspective of past history, with a focus on regional financial cooperation. First, recovery from the damage caused by the 1997 Asian financial crisis and the prevention of a recurrence of that crisis were the impetus for the launch of ASEAN+3 regional financial cooperation. The so-called "double mismatch," in which short-term foreign currency funds are borrowed and used for long-term local currency investment with repeated refinancing (rollovers), is viewed as having been a major cause of the crisis, so in order to prevent a recurrence, it was important to reduce foreign currency-denominated borrowing from advanced economies by allocating funds in the region to investment opportunities in the region rather than investing them outside the region. To this end, emphasis was placed on the development of local currency bond markets in the region, and the Asian Bond Markets Initiative (ABMI) was designed to accomplish this goal(1).

As is clear from the discussion above, the purpose of this initiative was to "achieve financial stability" through "regional financial integration."

For this reason, in addition to developing bond markets in each country, the ABMI also aimed to expand cross-border bond transactions. To the latter end, in 2010 the Credit Guarantee and Investment Facility (CGIF), an international organization whose main task is to guarantee cross-border issuances of local currency bonds in the region, and the ASEAN+3 Bond Market Forum (ABMF), an international body for discussing cross-border bond transaction issues, were established. As a result of the ABMI's various efforts, domestic bond markets in each country have expanded significantly (details later).

Meanwhile, aside from the ABMI, the Chiang Mai Initiative Multilateralisation (CMIM) Agreement, which created a mechanism for supplying foreign currency to support liquidity in times of crisis, was signed. The Chiang Mai Initiative (bilateral currency swapping network), established in 2000, was thus restructured into a multilateral mechanism in March 2010. In addition, the ASEAN+3 Macroeconomic Research Office (AMRO) was established in Singapore with the main purpose of managing and operating the CMIM mechanism and monitoring the regional economy for that purpose. Like the CGIF, it is an international organization.

Again, it can be said that the constant running through the above events was the aim of ensuring the stability and resilience of the financial system in the region and bringing about regional financial integration. Furthermore, strengthening the financial system in this way was naturally also intended to promote economic growth in the countries of the region.

Moreover, in the immediate aftermath of the 1997 crisis, Asian bond markets were extremely small, so initially the creation of bond markets was important. In other words, the objective was to "develop the financial system (financial and capital markets, financial institutions, financial personnel, etc.)."

(2) ASEAN Financial Integration

Second, a major development has been the progress made with ASEAN financial integration, which is closely tied to the establishment of the ASEAN Economic Community (AEC) in December 2015.

The AEC is part of the ASEAN Community. The ASEAN Community consists of three pillars, namely the ASEAN Political-Security Community (APSC), the ASEAN Economic Community (AEC), and the ASEAN Socio-Cultural Community (ASCC). At the 13th ASEAN Summit held in Singapore in November 2007, the decision was made to establish the ASEAN Community by 2015. At this time, a plan (AEC Blueprint) was presented that would set out a path for integration.

ASEAN financial integration is being pursued as a key component of the AEC Blueprint. The initiative to promote ASEAN financial integration is based on the Roadmap for Monetary and Financial Integration (RIA-Fin), which was approved by the ASEAN Finance Ministers in 2003. Based on this, the AEC Blueprint, which was produced in 2007, presented detailed plans for achieving the following goals: 1) financial services liberalization (FSL), 2) capital market development and integration (CMD), and 3) capital account liberalization (CAL). In April 2011, the ASEAN Financial Integration Framework (AFIF) was established at the ASEAN Central Bank Governors' Meeting. It presented an overall picture of the approach to financial liberalization and integration, with the aim of establishing semi-integrated financial and capital markets by 2020.

And in November 2015, the AEC Blueprint 2025 was announced. Financial stability and financial inclusion were added as goals to the existing goal of regional financial integration (three strategic objectives; see Table 1). Additional tasks included capital account liberalization, the development of payment and settlement systems, and capacity building (three cross-cutting areas). With regard to regional financial integration, it was decided to continue efforts based on the 2007 Blueprint.

Table 1 Challenges for the Financial Systems in ASEAN Countries

① Regional financial integration (integration of banks, insurance markets and capital markets) ・Further commit to liberalise financial services sector. ・Provide greater market access and operational flexibility for Qualified ASEAN Banks through ABIF. ・Promote deeper penetration in insurance markets through the ASEAN Insurance Integration Framework (AIIF). ・Further deepen and interlink capital markets by progressing towards more connectivity in clearing settlement and custody linkages, and allow investors and issuers to tap cross-border ASEAN capital markets efficiently. ・Promote the development of sovereign bond markets as well as corporate issuances.
② Financial stability ・Intensify macroeconomic and financial surveillance through identifying financial system risks and vulnerabilities, and intensifying exchange of key information among monetary and fiscal authorities. ・Enhance cross-border cooperative arrangements in relation to the implementation of ABIF. ・Make prudential regulations more cohesive, aimed at achieving greater consistency with international best practices and regulatory standards. ・Make effort to reduce debts of corporates, households and governments.
③ Financial inclusion ・Enhance the financing ecosystem for MSMEs and startups, including through the establishment of credit bureaus, credit guarantee institutions and debt resolution agencies. ・Expand the scope of financial access and literacy, as well as intermediary and distribution facilities such as digital payment services. ・Intensify the implementation of financial education programmes and consumer protection mechanisms. ・Promote the expansion of distribution channels which improve access to and reduce cost of financial services, including mobile technology and microinsurance. ・Responses to problems such as digital divide of people in rural areas, and aging of population must be strengthened.
④ Development of Financial System ・Development of banks, insurance sector, primary and secondary markets of bonds and stocks, money market, foreign exchange market, institutional investors (mutual funds, pension system), and nonbank financial institutions ・Growth of financial experts ・Development of financial infrastructure including payment and settlement systems ・Development of financial regulations and supervisory frameworks
⑤ Development of Infrastructure Finance
⑥ Development of Climate Finance ・Green Finance ・Transition Finance ・Finance for natural disaster related projects
⑦ Responses to digitalization of finance ・Responses to fintech expansion in each country ・Responses to cross-border digital financial transactions

Source: ASEAN Secretariat [2015b] pp.7-9 (edited)

(3) Summary of Challenges Facing the Financial Sector

From the discussion so far, the challenges facing the financial sector can be summed up (not necessarily in the order in which they were mentioned) as the three components of the AEC Blueprint 2025, namely 1) regional financial integration, 2) financial stability, and 3) financial inclusion, plus 4) development of the financial system.

Because these issues are interrelated, it is often difficult to draw a clear line between them. In addition, "promotion of economic growth" was mentioned in (1), and in connection with this, financial sector issues that concern specific sectors of the economy include 5) infrastructure finance, 6) climate finance (green finance, transition finance, and disaster response), and 7) digitalization of finance.

Finance for infrastructure development, i.e., 5), has been an issue for a long time, but looking at what has happened over the past 10 years, it is evident that interest in it has increased due to China's "Belt and Road Initiative," the establishment of the Asian Infrastructure Investment Bank (AIIB) by China, and Japan's focus on "quality infrastructure development" to counter these initiatives. In 2017, the Asian Development Bank [2017a] noted that $3.1 trillion ($210 billion annually) in infrastructure investment (after adjusted for climate change) would be required during the period 2016-2030, and that the financing shortfall of $102 billion each year would need to be provided by the private sector, which would thus need to become more proactive in developing infrastructure.

Climate finance, i.e., 6), is, along with 7) digitalization of finance, now one of the most important issues. ASEAN countries, which are highly vulnerable to the effects of climate change, need to expand sustainable finance, with a focus on decarbonization and natural disaster countermeasures. To this end, alongside promoting the issuance of ESG (Environmental, Social, and Governance) bonds, which the ABMI has been doing for some time, other comprehensive measures are required, such as expanding bank lending, developing systems such as taxonomies and information disclosure, and raising awareness among market participants(2).

In the context of 7) digitalization of finance, the adoption of FinTech is accelerating in ASEAN countries, as evidenced by the rapid increase in the use of mobile payment services, which was driven in part by the pandemic. Action in the area of cross-border transactions is also being stepped up. In November 2022, for instance, the central banks of the five original ASEAN countries (the Monetary Authority of Singapore in the case of Singapore) agreed on the Regional Payment Connectivity initiative. This is expected to enhance the linking of QR code payment services and to strengthen other cross-border payment services.

As well as enabling new types of transactions and delivering benefits associated with them, the increasing digitalization of finance also creates risks. Although it is expected to lead to greater financial inclusion and higher economic growth, the risks will also need to be addressed. In addition, the digitalization of finance is related to all the financial sector challenges mentioned above.

2. Trends with Regional Financial Cooperation

(1) Efforts under the ASEAN+3 Regional Financial Cooperation

(i) Accomplishments of the ABMI

Here I will take a closer look at the efforts to address these issues in the following order: regional financial cooperation, regional financial integration, and policy responses by each ASEAN country.

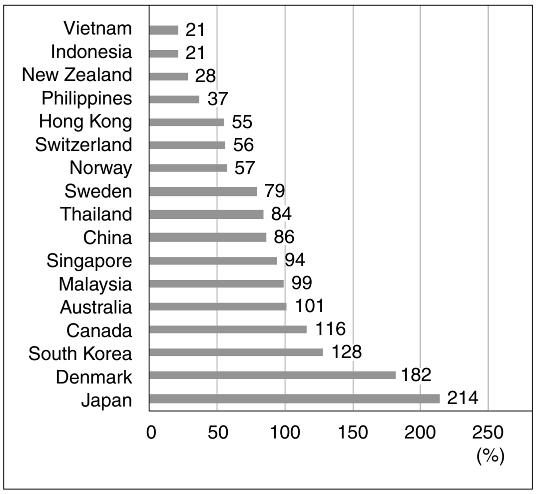
First, I will discuss ASEAN+3 regional financial cooperation. In the following, I will look at the ABMI's achievements and future challenges (ABMI Medium-term Road Map for 2023 to 2026)(3).

I already described the background to the launch of the ABMI above, and would like to add some more explanation. The decision was made at the ASEAN+3 deputies meeting in December 2002. At that time, Eichengreen and Hausmann [1999] presented the concept of "original sin," and it was argued that emerging economies could not raise funds in their own currencies abroad or procure long-term financing in their own currencies at home.

However, after the Asian financial crisis, Asian bond markets expanded rapidly. The total amount outstanding in the local currency bond markets of six ASEAN economies (the five original countries and Vietnam) and China and South Korea increased from $1.06 trillion in 2002 to $22.3 trillion at the end of 2021. This size is comparable to that of the U.S. Treasury and euro-denominated bond markets, and the ratio of outstanding bonds to GDP is also high (Fig. 1). Hence, in terms of degree of development, Asian bond markets are no longer inferior to those of advanced economies.

And functionally, too, the bond markets are now playing an instrumental role in economic growth, with financing from domestic bond markets being relied on to fund economic policy measures for facilitating recovery from the pandemic. Studies have also shown that the expansion of bond markets has reduced exchange rate volatility, which may have helped with financial stability in the region. The 2023 ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting concluded that the issue of original sin has been overcome in ASEAN countries(4).

Fig. 1 Ratio to GDP of Amount Outstanding in Domestic Bond Market (2019)



Source: ASEAN+3 Finance Ministers and Central Bank Governors' Meeting [2023a], p.3.

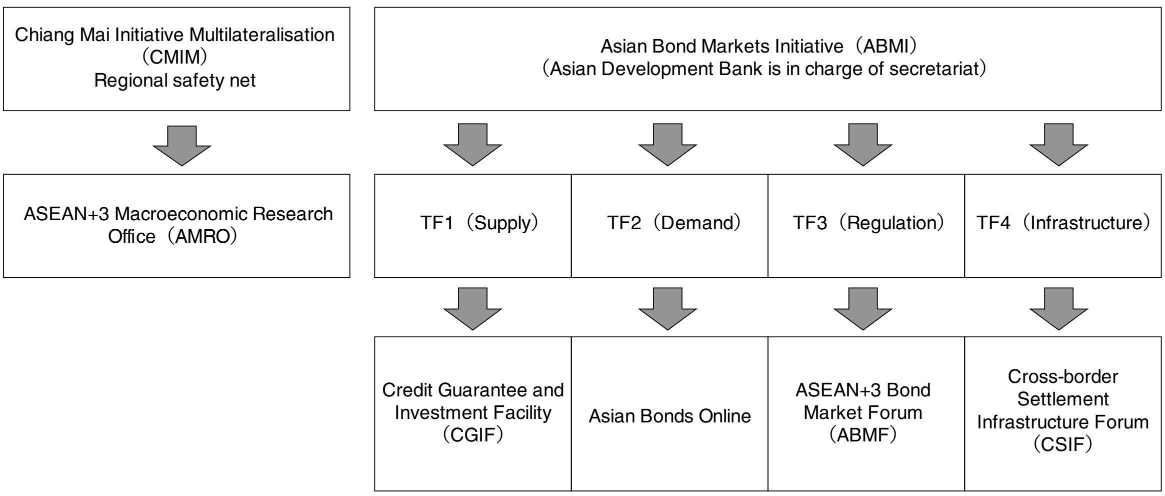
(ii) Issues in the Medium-Term Road Map for 2023 to 2026

However, not all problems have been resolved. The new roadmap(5) (the ABMI has been updating the roadmap every three to four years since 2008) presents five pillars:

The first pillar is promoting sustainable finance regionally. According to the roadmap, the development of sustainable finance will lead to an expansion in the circulation of funds within the region. In the past, for example, Japanese investors were reluctant to invest in bonds from ASEAN countries due to country and credit risk. However, recent surveys show that interest in ASEAN countries' green bonds has increased against the backdrop of greater keenness to invest in climate finance.

The ABMI is therefore focusing on strengthening efforts to build a sustainable finance ecosystem, primarily through Task Force 1 (TF1) (see Fig. 2). In promoting the issuance of ESG bonds, the emphasis is on issuances by banks within the region. Furthermore, Task Force 2 (TF2) concentrates on data collection and sustainable finance impact assessment from the perspective of expanding investor participation. Sufficient data is lacking, and issuers of green bonds struggle to demonstrate that their projects qualify. Growing

Fig. 2 Structure of ASEAN+3 Regional Financial Cooperation



Notes: TF stands for Task Force.
Source:ASEAN+3 Finance Ministers and Central Bank Governors' Meeting [2023a], p.8.

concerns about greenwashing also increase the need for data.

The second pillar is improving the regulatory and market framework and creating a better foundation for cross-border transactions. This is a continuation of the efforts of the ABMF, which is a member of TF3, to standardize regulations and market frameworks as part of the construction of a platform for the issuance of ASEAN+3 Multi-Currency Bond Issuance Framework (AMBIF) bonds, which are bonds issued based on common rules within the region.

The third pillar is promoting digitalization to integrate the ASEAN+3 financial markets. The key to digitalization is "standardization," which requires the standardization of data, technology, laws, operations, etc. Through standardization, the aim is to expand interoperability and deepen regional financial integration. This is also mainly an ABMF initiative.

Specifically, efforts are being made to standardize the content of reports on foreign exchange transactions made to the authorities in countries in the region. In addition, cross-border payments are closely related to standardization, and in connection with this, the adoption of ISO 20022 (international standard format for financial communication messages) is progressing in various countries, and attempts are being made to utilize LEI (Legal Entity Identifier[(6)]) codes.

Furthermore, it has been pointed out that the digitalization regarding financial regulations (RegTech, SupTech) reduces the burden of regulatory compliance on financial institutions and the burden of regulatory supervision on financial authorities, as well as promoting cross-border transactions.

In addition, the use of distributed ledger technology (DLT) and blockchain is expected to change financial operations and the landscape. In connection with this, an initiative called Project Tridecagon is underway to utilize blockchain technology (including asset tokenization) in line with the ABMF's long-standing efforts to integrate the cash and securities settlement systems of the region's countries.

The fourth pillar is promoting LCY (local currency) liquidity provision to mitigate risk in cross-border transactions. At present, the U.S. dollar is used for most financial transactions in the region, which makes it difficult to shorten the settlement cycle and poses the risk that the region's financial markets could fail in a cascading manner in the event of a shortage of dollar liquidity.

One way to avoid this would be to expand the Cross-border Collateral Arrangement (CBCA) for local currencies (this is being discussed mainly by the Cross-border Settlement Infrastructure Forum (CSIF) of TF4). This is a system whereby a foreign bank (a bank in Country B) that is struggling to procure local currency in a certain country (Country A) can procure Country A currency from the central bank of Country A using bonds denominated in Country B currency as collateral (a contract is concluded between the central banks). This should lead to a decrease in dependence on the dollar, as it would eliminate the need for use of the dollar as an intermediate currency to procure the currency of Country A. However, at present, such a system is only available for use in times of emergency.

As for foreign exchange risk, it has been noted that there are no foreign exchange swap markets in ASEAN countries for risk hedging. The presence of a highly liquid secondary bond market and an active short-term money market is a prerequisite for the establishment of foreign exchange swap markets, so developing these markets is another way to reduce foreign exchange risk.

The fifth pillar is continued and more tailored support for LCY bond market development, particularly in ASEAN's least-developed countries. Some countries (principally Cambodia, Laos, and Myanmar) have been slow to develop their bond markets and will continue to receive support from the Technical Assistance Coordination Team (TACT).

The above has highlighted the characteristics of the ABMI's current initiatives, which can be summarized as follows: (1) a strengthening of efforts in climate finance (sustainable finance), which has become increasingly important in recent years, (2) ongoing development of regulations, rules, and market infrastructure for regional financial integration while incorporating new technologies such as blockchain, and (3) efforts to improve the financial system in each country (e.g., support with the development of bond markets in ASEAN's least-developed countries, enhancement of liquidity in the secondary bond market, and exploration of other measures to avoid foreign exchange risks).

It is highly commendable that such diverse efforts have been made over the years since the Asian financial crisis, and the hope is for further strengthening of regional financial cooperation in the future.

In light of recent developments, it will be important to focus on financial inclusion for individuals, small and medium-sized enterprises (SMEs), and the elderly, and to promote sustainable economic growth. Regional financial integration also contributes to financial inclusion, and it goes without saying that the power of digitalization should be utilized to promote financial inclusion and regional financial integration. In addition, supporting the markets of ASEAN's least-developed countries, which have been lagging behind, also helps to promote regional financial integration.

(iii) New Initiatives in ASEAN+3 Regional Financial Cooperation

As part of the process of ASEAN+3 regional financial cooperation, the establishment of four working groups (WGs) was announced in 2021. They are Infrastructure Financing (WG1), Macro-structural Instruments (WG2), Strengthening Financial Resilience against Natural Disasters (WG3), and Enhancing Policy Coordination for Technological Advancement (WG4). Using the terms of Table 1, these correspond to 5) infrastructure finance, 2) financial stability, 6) climate finance, and 7) digitalization of finance, respectively.

Looking at the progress of the WGs as stated in the 2023 Joint Statement dated May 2, first, under WG1, a joint report from the Asian Development Bank (ADB) and ASEAN+3 entitled "Reinvigorating Financing Approaches for Sustainable and Resilient Infrastructure in ASEAN+3" was prepared.

Second, under WG2, development of the ASEAN+3 Macro-structural Framework and Program Toolkit is underway with the support of AMRO.

Third, under WG4, progress is being made with work on enhancing regional policy coordination on FinTech and introducing the Open Banking System as one of the areas for technical cooperation in the region. In addition, AMRO released a report (AMRO [2023]) covering the benefits and risks of FinTech and the direction for future regional cooperation in FinTech.

Fourth, general high-level principles for transition finance have been developed.

Fifth, research is being conducted on the use of local currencies in cross-border transactions (including trade and capital transactions) within the region. AMRO is expected to strengthen its role in providing support with intraregional payment system connectivity and intraregional use of local currencies. In addition, AMRO and other institutions are conducting research on topics such as corporate and household debt, which have the potential to significantly impact financial stability, and fiscal policy gaps associated with sustainable finance.

(iv) Comment

As the above shows, the ASEAN+3 regional financial cooperation framework has achieved significant results in terms of the development of Asian bond markets, and is further expanding the scope of its activities. Looking ahead, there are hopes that it will produce results in tackling numerous issues, but to that end, it will be important to establish effective collaboration across many projects.

Japan has played a central role in regional financial cooperation since the Asian financial crisis erupted. Going forward, it should continue to be actively involved so as to maintain its position. Strengthening relations with ASEAN countries is a key task for Japan, and financial cooperation is a vital tool for that.

As for the ABMI, its main focus is, as mentioned above, promoting sustainable finance and regional financial integration. There are many aspects to promoting integration, and numerous people are involved, so coordination will be important. And from the standpoint of delivering sustainable economic growth, it will be necessary to strive to make a greater contribution to financial inclusion for individuals and SMEs.

(2) Initiatives of the APEC Business Advisory Council (ABAC)

ABAC is the only official private-sector advisory body to APEC, and the main organizations affiliated with the Finance and Economics Working Group, one of its five working groups, are the Asia-Pacific Infrastructure Partnership, the Asia-Pacific Financial Forum (APFF), and the Asia-Pacific Financial Inclusion Forum(7). Of these, the APFF is a public-private partnership launched in 2013 with the aim of developing sound and integrated financial markets and services in the Asia-Pacific region.

In a 2023 report from ABAC to the APEC finance ministers (ABAC [2023]), it was acknowledged that economic fragmentation is increasing in the face of various uncertainties in the world, and that this seriously threatens APEC's vision of "free and open trade and investment" and "regional integration." The report stated that trade and technological development would contract and become more fragmented as a result, and estimated that up to 12% of the world's GDP would be lost.

To forestall such fragmentation, the APEC Finance Ministers' Process proposes that the financial sector can take the initiative in leveraging technology in order to increase efficiency and effectively fulfill the key roles outlined in Table 2. Although expressed in different ways, these goals can be seen as overlapping to some extent with the challenges for the financial sector presented in Table 1.

The report provides specific recommendations for achieving the goals, divided into "Building Interoperable Digital Financial Systems" and "Mobilizing International Capital to Accelerate Sustainable Transition" (Table 3).

According to ABAC, given that the global economy is already on the verge of fragmentation, it would not be appropriate to also pursue DX and tackle climate change in a fragmented manner. In line with the above recommendations, coordinated action is crucial, and the financial system is the key to achieving this. Such coordination will enable the Asia-Pacific region to move back from the fragmentation path to the integration path.

3. Trends in ASEAN Financial Integration

(1) What is Regional Financial Integration?

(i) Background

In what follows, I will revisit the aforementioned regional financial integration and examine

Table 2 Roles of the Regional Financial Sector Emphasized by the APEC Business Advisory Council

• more affordable and speedier financing of trade across markets and supply chains • providing more efficient and safer ways for consumers and business owners to access a wider variety of services by leveraging their data • enabling more efficient large-value payment and settlement transactions among financial institutions • facilitating expanded safe and trusted use and flows of data in financial services across jurisdictions • mobilizing capital across the region to finance projects and innovations that can accelerate member economies' and companies' progress toward their net zero carbon emissions goals

Source: ABAC [2023], p.2.

Table 3 Recommendations from the APEC Business Advisory Council

Building Interoperable Digital Financial Systems
・End-to-End Digitalization of Trade and Supply Chain Finance ・Interoperable Open Data Systems ・Expanded Cross-Border Data Sharing and Privacy Enhancing Technologies ・Promoting the Development of Interoperable Wholesale CBDCs
Mobilizing International Capital to Accelerate Sustainable Transition
・Creating a Collaborative Framework for Financing Sustainable Transition ・Financing Just and Affordable Energy Transition ・Financing Sustainable Innovation

Source: ABAC [2023]

it in more detail(8).

I will start by re-considering how it was originally conceived. Although financial and capital markets in ASEAN countries have made significant progress, they remain relatively small and vulnerable to external shocks. In addition, progress with regional financial integration has been hindered by the presence of capital transaction regulations that reflect this vulnerability. As a result, the progression of regional financial integration has been gradual, and it lags behind the level of integration of the real economy, i.e., in areas such as trade and direct investment.

With ASEAN financial integration, the basic policy was to promote the liberalization of domestic financial services and capital transactions, and to integrate financial and capital markets throughout the ASEAN region through regulatory harmonization and other measures. In a nutshell, it was about "integration through liberalization and harmonization."

This would allow the financial and capital markets of ASEAN countries, which are small when looked at individually, to gain economies of scale. In addition, competition among markets in the region would encourage the strengthening of the financial system and financial institutions. Furthermore, these enhancements would streamline the allocation of funds and facilitate the provision of appropriate financial services for various national and cross-border economic activities in the region. The above has illustrated that the aim of pushing for regional financial integration is to reduce dependence on capital and financial systems outside the region and to "allocate regional savings to regional investment."

(ii) Progress

As mentioned earlier, the 2007 AEC Blueprint declared that the following initiatives would be pursued: 1) financial services liberalization, 2) capital market development and integration, and 3) capital account liberalization. These were positioned as components for accomplishing the AEC's overarching objective of striving for a "single market and production base" and establishing an integrated and smoothly functioning regional financial system.

In November 2015, just before the launch of the AEC at the end of December that year, the AEC Blueprint 2025, presenting the integration plan for the next 10 years, was announced. Besides aiming for regional financial integration, the Blueprint also set the goals of financial inclusion and stability, and common themes related to these (liberalization of capital flows, development of payment and settlement systems, and capacity building) were added for consideration.

In April 2016, the AEC 2025 Strategic Action Plans for Financial Integration from 2016-2025 were endorsed at the 2nd ASEAN Finance Ministers' and Central Bank Governors' Meeting (Table 4). The plans divide the 10-year period until 2025 into 2016-2017, 2018-2019, 2020-2021, and 2022-2025, with targets and milestones for each sub-period for regional financial integration, financial inclusion, and financial stability.

Table 4 End Goals of ASEAN Economic Community 2025 Strategic Action Plans for Financial Integration from 2016-2025

Financial Services Liberalization	・Greater role of Qualified ASEAN Banks (QABs) in facilitating intra-ASEAN trade and investment ・More integrated financial services sector through enhanced financial liberalisation among AMS
Capital Market Development and Integration	・Interconnected ASEAN Stock Markets ・Deep and liquid ASEAN capital markets ・Improve access to capital markets ・Greater private sector engagement to understand their insights in ASEAN financial markets ・Facilitate cross-border of collective investment schemes (CIS) in ASEAN
Integration of Payment and Settlement Systems	・An ASEAN payment system that is safe, innovative, competitive, efficient and more interconnected
Capital Account Liberalization	・Substantial liberalisation in ASEAN member states' capital account
Financial Inclusion	・Achieve financial inclusion targets (Reduction of average financial exclusion level for the ASEAN region from 44% to 30% by 2025; Enhanced readiness of financial inclusion infrastructure for ASEAN region from 70% to 85% by 2025; Increased access and quality of financial services to all segments of society; Increased level of financial literacy and consumer protection) ・Promote retail access to bond market ・Improvements in consumer welfare (Promote efficiency, innovation and the use of regional currency; Build domestic near real-time RPS capabilities)
Harmonization of Laws, Regulations and Institutions	・Greater coherence of banking regulations for all AMS to support financial integration, consistent with international standards
Financial Stability	・Greater regional strength on the banking sector and market confidence in regional stress to support ASEAN financial sector resilience ・Promote financial stability coordination ・Maintain financial stability and deepen bond markets ・Convergence of prudential regulation ・Strengthened policy dialogue and information exchange mechanism on capital flows statistics and capital flow measures among AMS

Notes: AMS stands for ASEAN member states.
Source: ASEAN Economic Community 2025 Strategic Action Plans (SAP) for Financial Integration from 2016-2025

(iii) What is Regional Financial Integration?

Regional financial integration refers chiefly to 1) financial services liberalization (expansion of cross-border activities by banks and other financial institutions), 2) capital market development and integration, 3) integration of payment and settlement systems, 4) significant capital account liberalization, 5) internationalization of regional currencies (cross-border use) in connection with 4), and 6) harmonization of regulations and systems within the region, as shown in Table 4. In addition, to successfully implement these measures, 7) it will be necessary for countries to focus on improving their financial systems so that they are all at a similar level. Regarding this final point, 7), OJK (Otoritas Jasa Keuangan: Indonesia Financial Services Authority), for example, on p.6 of "The Indonesian Financial Services Sector Master Plan 2021-2025," points out that, based on the premise of intensifying competition due to regional financial integration, it will be necessary to improve the efficiency of the domestic financial services sector, diversify products and services, and provide high-quality services using technology. And I have already mentioned the importance of support from the ABMI for ASEAN's least-developed countries.

When promoting regional financial integration, disparities between countries in the degree of economic/financial development and differences in legal structures/systems create obstacles. Therefore, it will be quite difficult to directly integrate financial and capital markets when tackling the seven challenges described above. Besides 7), namely improving each country's market, tasks that will be relatively easy to tackle include rule harmonization (6) harmonization of regulations and systems within the region) and development of financial infrastructure to support cross-border transactions (3) integration of payment and settlement systems).

(iv) Cross-border Use of Regional Currencies

To facilitate cross-border use of regional currencies, which was discussed earlier, an arrangement called the Local Currency Settlement Framework (LCSF) has been established(9). In the ASEAN region, most external transactions, such as for trade and direct investment, are conducted in dollars, so expanding the use of local currencies to lessen foreign exchange risk is a key task. This is both a new problem and an old problem, as it has lingered since the 1997 Asian financial crisis, when borrowing in foreign currencies caused issues.

The LCSF allows for the cross-border use of local currencies for transactions where their use would normally be restricted. This permission is granted in exceptional cases, with the transactions conducted under the supervision of the authorities. In practice, direct transactions between local currencies are executed by banks selected as Appointed Cross Currency Dealers (ACCDs), which are deemed capable and sound enough to handle such transactions. In other words, external transactions are executed in the currency of one of the two regional countries that are party to the transaction concerned, with the two currencies exchanged directly without going through the dollar.

The LCSF was adopted by the central banks of Thailand and Malaysia in March 2016, with Indonesia joining in December 2017. Indonesia had limited its scope to trade and services transactions, but expanded the scope to encompass direct investment and transactions related to primary and secondary income balances with Thailand in December 2020 and with Malaysia in August 2021. In 2019, the Central Bank of the Philippines also signed a memorandum of understanding (MOU) concerning the LCSF with the central banks of Indonesia, Malaysia, and Thailand.

While the proportion of external transactions conducted using the LCSF is not yet high, it is on the rise, which could make ASEAN currencies more resilient in the long run. Phoebe [2022] points out that it is important for countries to expand use of the LCSF, especially by SMEs, to realize its various benefits, such as lowering the cost of foreign exchange transactions for companies.

Bank Indonesia signed similar MOUs with Japan's Ministry of Finance in 2020 and the People's Bank of China in 2021. Japan's Ministry of Finance has also established cooperative frameworks with the central banks of Thailand (2018) and the Philippines (2019) to promote the use of local currencies.

(v) Integration of Payment and Settlement Systems

Integration of payment and settlement systems has also been an issue since the Asian financial crisis of 1997. For example, in 2006, the Asian Payment Network, which comprises providers of payment infrastructure in each ASEAN country, was launched at the behest of central banks with the aim of establishing common standards and guidelines. Spurred by the fact that the improvement of cross-border payment systems has become a global issue in recent years, ASEAN countries have been focusing on efforts to integrate regional payment systems. The ASEAN Working Committee on Payment and Settlement Systems (WC-PSS), which was set up in 2010, has produced the ASEAN Payments Policy Framework for Cross-border Real Time Retail Payment and its Implementing Policy Guidelines (finalized in September 2019), and activities are being conducted based on these documents.

Specifically, in addition to bilateral efforts to link the real-time retail payment systems and QR code payments of each country, the three countries of Singapore, Malaysia, and Thailand are actively involved in a project to explore the use of wholesale CBDCs for cross-border payments. And three other countries of Indonesia, Philippines and Vietnam are studying and considering domestic retail CBDC issuance.

(2) Current State of Regional Financial Integration: Policy Side

(i) Financial Services Liberalization (FSL)

Next, I will look at the recent efforts of the financial authorities of ASEAN countries concerning regional financial integration, based on the Joint Statement of the 10th ASEAN Finance Ministers' and Central Bank Governors' Meeting (August 25, 2023).

First, with regard to financial services liberalization, the working committee (WC-FSL) is developing a regulatory framework under the ASEAN Framework Agreement on Services (AFAS), positioning it as liberalization of trade in services as part of a free trade agreement(10).

As for the ASEAN Banking Integration Framework (ABIF, now a working committee called WC-ABIF), which was established in 2011 to promote financial services liberalization in the banking sector, progress is being reviewed from the perspectives of institutions and banking regulations, and changes to the ABIF Guidelines (finalized in December 2014) are being considered to reflect financial digitalization. And regarding the progress made in the development of the framework for Qualified ASEAN Banks (QABs), according to the ASEAN Secretariat (https://asean.org/our-communities/economic-community/finance-integration/sectoral-bodies/), three documents on ABIF arrangements have been signed by member states. In Indonesia, Malaysia's CIMB and Maybank have been designated as QABs.

In addition, a platform for strengthening cybersecurity has also been established in ASEAN, and training is being provided for personnel in this area to enable them to deal with incidents.

(ii) Capital Account Liberalization (CAL) and Capital Market Development (CMD)

The working committee in this area (WC-CAL) has promoted deregulation by creating a heat map to monitor progress with capital account liberalization in member states and strengthening the framework for policy dialogue. Efforts continue to be made to strengthen policy dialogue and information exchange among member states on capital flow trends, statistics, and regulations.

And in connection with this, the ASEAN Local Currency Transactions Task Force (LCT-TF) has been established and the High-Level Principles on the LCT Framework have been approved. These developments will enhance the accessibility and efficiency of local currency transactions in the region and facilitate local-currency use by market participants.

Next, with regard to capital market development, the working committee (WC-CMD), in cooperation with the ASEAN Capital Markets Forum (ACMF, established in 2004 and comprised of the regulators of the capital markets in each country in the region), has been working on various initiatives for capital market development, contributing to cooperation and integration in capital markets in the region (Table 5). Recently, the focus has been on infrastructure finance and sustainable finance. For example, the ACMF has issued the ASEAN Green Bond Standards, ASEAN Social Bond Standards, and ASEAN Sustainability Bond Standards. The ACMF has also launched an initiative called Digital Oversight to support

Table 5 Initiatives of the ASEAN Capital Markets Forum (as of July 2015)

	Name of scheme
(a)	Expedited Review Framework for Secondary Listings
(b)	ASEAN Corporate Governance Scorecard
(c)	ASEAN Disclosure Standards
(d)	Streamlined Review Framework for the ASEAN Common Prospectus
(e)	ASEAN Trading Link
(f)	Cross-Recognition of Qualification on Education and Experience of Market Professionals
(g)	ASEAN Framework for Cross-Border Offerings of Collective Investment Scheme (CIS)
(h)	Tradable ASEAN Indices
(i)	ASEAN Capital Market Development Program

Source: ASEAN Secretariat [2015a]

the exchange of opinions and information on the development of digital-related regulations and other topics.

(iii) Connection of Payment and Settlement Systems (PSS)

In this field, the bilateral connection of cross-border QR code payments and real-time retail payment systems, the expansion of the Regional Payment Connectivity roadmap to countries in the region and beyond, and a multilateral payment initiative (Project Nexus) are ongoing, and in response, the role of the working committee (WC-PSS) is being strengthened and a structure for monitoring progress in the development of payment and settlement systems is being put in place.

(iv) Infrastructure Finance and Sustainable Finance

The roles of the ASEAN Infrastructure Fund (AIF), which was established in 2011 by ASEAN countries and the ADB to promote infrastructure development in the region through joint financing by ASEAN member states and the ADB, and the ASEAN Catalytic Green Finance Facility, which was set up in April 2019 based on the AIF to harness public-sector finance to mitigate risks for green infrastructure projects and act as a catalyst for attracting private-sector finance, have been strengthened. As a result, the AIF has increasingly taken on the function of a green fund for ASEAN.

In addition, numerous initiatives for sustainable finance are in motion, such as strengthening the ASEAN Taxonomy (Version 2) and promoting energy transition. So various organizations such as the WC-CMD, the ACMF, central banks in the region, and the ASEAN Insurance Regulators' Meeting (AIRM) are becoming increasingly active.

(v) Financial Inclusion

Levels of financial inclusion are steadily improving. The 2025 target of the Strategic Action Plans for ASEAN Financial Integration 2016-2025 is to reduce the financial exclusion rate (the percentage of adults who do not have a bank account or mobile money account) to 30% or less, and the figure is already 21.8% (according to data from each country). The Working Committee on Financial Inclusion (WC-FINC) is taking various steps to improve levels of digital financial inclusion and digital financial literacy. For example, the possibility for mutual authentication of digital IDs within the region is currently being explored. In addition, WC-FINC and the ASEAN Coordinating Committee on Micro, Small and Medium Enterprises (ACCMSME) are jointly implementing initiatives for lending to SMEs and digital financial literacy.

(vi) Disaster Risk Finance

In this field, ASEAN supports policymakers in quantifying exposure to the risk of natural disasters and recognizing the gap between the current finance available and the amount required, adopting effective financing methods, and making plans for capacity building. It should be noted that the scope of this initiative now includes health risks due to pandemics.

(vii) Summary

To sum up the above, policy initiatives aimed at ASEAN financial integration are diverse, involving various working committees and related organizations such as the ACMF. Due to differences in the economic and financial development of each country, as well as their myriad legal systems and regulations, little progress has been seen with substantive integration measures such as QABs and ASEAN Trading Link (connection of securities exchanges in each country). However, overall motivation remains strong and gradual progress can be observed. To accelerate overall progress, technical assistance to relatively least-developed countries is also considered important.

Japan is focusing on ASEAN+3 regional financial cooperation, but it will need to leverage the knowledge and experience gained from this cooperation to take effective action to contribute also to regional financial integration.

(3) Current State of Regional Financial Integration: Statistics Side

(i) Trend with Intraregional Transaction Ratio

The external assets/liabilities of Asia-Pacific countries increased from $11.5 trillion in 2010 to $27 trillion in 2021 (Table 6). Among assets, equity investment and direct investment were the main drivers of the increase, while liabilities saw relatively even rises across the board.

Table 6 Cross-border Assets/Liabilities of Asia-Pacific Countries

(trillion dollars, magnitude of change)

		2010 (A)	2021 (B)	B/A
Assets	Bond investment	3.6	5	1.4
	Equity investment	2.0	7	3.5
	Direct investment	2.5	10	4.0
	Bank lending	3.4	4	1.2
	Total	11.5	27	2.3
Liabilities	Bond investment	1.7	4	2.4
	Equity investment	2.9	7	2.4
	Direct investment	4.8	11	2.3
	Bank lending	2.1	5	2.4
	Total	11.5	27	2.3

Source: Asian Development Bank [2017b], pp.38-39, Asian Development Bank [2023], p.101, p.103.

Table 7 shows changes over time in intraregional ratios by transaction type (i.e., percentage of external transactions that are conducted between countries in the region). Regarding assets, the ratios for non-equity investments have increased compared to 2010, which may reflect the expansion of bond markets in the region, the increase in foreign direct investment in the region, and the expansion of local bank activity in the region. However, the increase in the intraregional ratio for bank lending has been somewhat discontinuous, and the causes of this are unclear. In addition, the intraregional ratios for bond and equity investment remain at around 20%.

As for liabilities, meanwhile, apart from bank lending, the intraregional ratios have risen only slightly. Looking at these figures in combination with the increase in the intraregional ratios for assets (outward investment), it can be assumed that investment from outside the region is growing for each type of investment.

On the whole, progress is being made with regional financial integration, though in the case of portfolio investment, advances have been moderate. The ratio of intraregional investment and lending, which is based on the sum of the four

Table 7 Intraregional Ratios of Cross-border Assets/Liabilities of Asia-Pacific Countries

(%)

(Assets)	Bond investment	Equity investment	Direct investment	Bank lending
2010	11.9	24.2	35.3	16.3
2015	16.7	20.0	39.4	22.1
2017	16.4	18.1	40.1	22.6
2018	16.8	18.0	39.9	21.8
2019	17.9	19.9	47.4	48.3
2020	18.9	21.4	50.3	41.4
2021	21	21	51	42

(Liabilities)	Bond investment	Equity investment	Direct investment	Bank lending
2010	25.7	16.6	42.9	19.2
2015	27.0	17.4	44.3	23.0
2017	25.5	15.1	44.1	27.2
2018	25.6	16.1	42.9	26.2
2019	28.8	19.0	42.6	37.5
2020	28.5	20.3	45.8	35.9
2021	29	21	46	38

Source: Asian Development Bank, *Asian Economic Integration Report*, various issues types of transactions, was about 36% in 2021 for both assets and liabilities.

(ii) Trend with Ratios by Currency[11]

Table 8 shows ratios of external assets and liabilities by currency. 44% of assets are denominated in dollars while 63% of liabilities are denominated in domestic currency. This is because direct investment and equity investment are denominated in the country's own currency, and in the case of bond investment and bank lending, 58% of assets and 48% of liabilities are denominated in dollars. Regarding the dollar-denominated ratio for assets/liabilities overall, since 2010 it has risen slightly for assets and been on a downward trend for liabilities.

With respect to trade, the U.S. accounts for 13% and 9% of Asia-Pacific goods exports and imports, respectively, while the dollar-denominated shares of invoice currencies are 78% and 75%, respectively[12]. In contrast, as for the EU, the U.S. accounts for 8% and 5% of goods exports and imports, respectively, while the dollar-denominated shares of invoice currencies are 30% and 48%, respectively.

So overall, Asia-Pacific countries remain highly dependent on the dollar. This means that when the dollar appreciates, inflation inevitably rises in these countries.

Table 8 By-Currency Ratios for Cross-border Assets/Liabilities of Asia-Pacific Countries (2021)

(Assets) (%)

	Overall	Bond investment and bank lending
Dollar	44	58
Other	15	14
Asian currencies other than own currency	12	2
Euro	11	12
Renminbi	7	1
Own currency	6	8
British pound	3	2
Japanese yen	2	3
(Total)	100	100

(Liabilities)

	Overall	Bond investment and bank lending
Own currency	63	11
Dollar	20	48
Other	9	22
Japanese yen	4	10
Euro	3	8
British pound	1	1
(Total)	100	100

Source: Asian Development Bank [2023], pp.104-105.

(iii) Trends with Capital Flows and Their Relationship with Regional Financial Integration

Gross capital flows to Asia-Pacific countries doubled from \$0.7 trillion on average in 2001-2010 to \$1.4 trillion on average in 2011-2020[13]. This is in contrast to the decline in capital flows to advanced economies from \$4.3 trillion to \$3.0 trillion.

However, as a percentage of GDP, it averaged 5.5% in both periods. In addition, capital outflows (outward investment) by residents averaged \$0.8 trillion and \$1.6 trillion per year in the two periods, making Asia-Pacific countries net capital exporters.

Moreover, comparing the two periods reveals that the volatility of capital flows is on a downward trend. This is mainly due to the stability of capital flows from advanced economies since the global financial crisis, but it is also possible that capital flow management measures, foreign exchange policies, and macroprudential policies in Asia-Pacific countries have worked effectively.

Overall, despite the increase in capital inflows to Asia-Pacific countries, the risks associated with them have been contained. However, this does not mean that they can neglect readiness for financial crises. What is required is detailed monitoring of capital flows, appropriate policy responses, and the sharing of information/experiences through regional cooperation.

In addition to supporting integration in the real economy, the promotion of regional financial integration will strengthen financial stability from various angles, and will also be effective as a means of addressing risks associated with capital flows. However, there is also the view that regional financial integration could raise the risk of spillover in the event of a crisis. While this is controversial, if such risks are factored in, the conclusion drawn would be that there is a pressing need for strengthening bilateral currency swaps and the CMIM mechanism in preparation for crises.

4. Financial Sector Policies of ASEAN Countries and What Japan Can Do to Support Them

ASEAN nations are comprehensively addressing the financial sector challenges outlined in Table 1. Each country prepares a medium-term plan called a "blueprint" or "master plan" for a four- to five-year period, and the central bank and other financial authorities take the lead in implementing it (see Table 9 for the example of Malaysia).

While Japan has focused on bilateral financial cooperation since around 2013, it will be important for it to continue to provide experience, knowledge, and technology to meet the needs of partner countries. In Malaysia, for example, where the population is graying, there seems to be room for Japan, which is ahead of the curve in terms of population aging, to supply its wealth of know-how in areas such as designing systems for safeguarding standards of living for the elderly and ensuring that they do not suffer financial exclusion. In addition, the digitalization of finance and sustainable finance are challenges shared by both countries, and active cooperation would be desirable.

Thailand is working on digitalization, sustainable finance, financial inclusion, etc., and there is plenty of potential for cooperation in such areas with advanced economies such as Japan.

Singapore, meanwhile, is a financially advanced country and an international financial center, so Japan should refer to Singapore's policies while building a mutually beneficial cooperative relationship.

As for other ASEAN countries, on the other hand, there are still areas in which more basic financial system development is required, and there is room for cooperation from this perspective as well. A financial system comprises elements such as financial institutions, financial/capital markets, financial products, financial infrastructure, financial regulations, the specialized financial professionals from the public and private sectors involved in building and operating the financial system, and the providers and users of funds who are customers of the financial system. All these elements must be developed, but the focus probably ought to be on nurturing financial professionals and adopting proven financial systems from overseas.

Table 9 Policies to Develop the Financial Sector by Each ASEAN Country (the Example of Malaysia)

Financial Sector Blueprint 2022-2026
1. Fund Malaysia's economic transformation 2. Elevate the financial well-being of households and businesses 3. Advance digitalisation of the financial sector 4. Position the financial system to facilitate an orderly transition to a greener economy 5. Advance value-based finance through Islamic finance leadership
Capital Market Masterplan 2021-2025
1. Catalysing Competitive Growth 2. Empowering Investors for a Better Future 3. Shaping a Stakeholder Economy with Sustainable and Responsible Investment and Islamic Capital Market

Source: Bank Negara Malaysia "Financial Sector Blueprint 2022-2026", Securities Commission Malaysia "Capital Market Masterplan 2021-2025"

5. Singapore's Financial Sector Policies

(1) Financial Services Industry Transformation Map

(i) Financial Services Industry Transformation Map 2016-2020

Singapore has emphasized the financial industry for economic growth and been striving to establish and maintain a position as a global and Asian financial center. In October 2017, the Monetary Authority of Singapore (MAS) announced the Industry Transformation Map (ITM) for Financial Services 2016-2020. By aspiring to be an international financial center, Singapore aims to 1) connect global markets, 2) support Asian development, and 3) contribute to the Singapore economy.

To achieve these goals, key business strategies include becoming 1) an international hub for wealth management, 2) a hub for asset management in Asia (including domiciling funds in Singapore), and 3) a center for foreign exchange trading in the Asian time zone (in terms of determining exchange rates and providing liquidity for transactions).

Furthermore, key business areas emphasized from the perspective of Asian growth include serving as 1) a center for corporate fundraising in Asia, 2) a hub for full-service infrastructure finance in Asia, 3) a center for bond trading in Asia (expanding the issuance of bonds by Asian companies), and 4) a center for insurance services that address risks arising in Asia (utilizing blockchain technology).

Additionally, the Financial Services ITM includes components for continuous innovation and technology adoption, as well as programs to enhance the skills of financial human resources and increase employment.

Initiatives related to innovation (and related regulations) include 1) promoting innovation through the use of APIs (application programming interfaces), 2) building shared infrastructure for electronic payments, digital IDs, and KYC (know your customer) frameworks, 3) developing new tech such as distributed ledger technology, 4) fostering cross-border cooperation, and 5) establishing regulations that promote innovation while considering risks.

Regarding skills and employment, specific mention is made of ensuring the availability of specialized personnel, particularly in IT-related fields, and enhancing skills in growth areas to increase employment.

While paying attention to the diverse challenges outlined in Table 1, the declared objective is to establish Singapore as an international financial center that attracts money from around the world and supplies it to Asia. In other words, the goal is financial integration. On the other hand, given that nearly 100% of the population has a personal bank account, there is minimal mention of financial inclusion.

According to MAS, the financial services sector grew at an average annual rate of 5.7% from 2016 to 2020 (the target was 4.3%), and employment in the sector (net) increased by an average of 4,100 people per year (the target was 3,000).

(ii) Financial Services Industry Transformation Map 2025

In September 2022, MAS unveiled Financial Services ITM 2025 (Table 10). This builds upon the Financial Services ITM 2016-2020, while reflecting the further advancement of financial digitalization over the past five years and the increasing importance of transitioning to a global net-zero.

(2) Definition of International Financial Centers, Factors behind Their Formation, and Their Relationship with Regional Financial Integration

(i) Global Financial Centres Index

Since March 2007, the London-based think tank Z/Yen has been indexing the competitiveness of major financial centers worldwide (GFCI: Global

Table 10 Content of Financial Services Industry Transformation Map 2025

Enhance Strengths of Asset Classes (in which Singapore plays a key regional or global role)	• Foreign exchange: Broaden and deepen the electronic foreign exchange (FX) trading ecosystem.
	• Insurance: Catalyse insurance risk advisory and alternative risk transfer solutions for Asia, and facilitate the participation of capital markets in risk financing.
	• Wealth management: Become Asia's centre for philanthropy.
	• Asset management: Enhance the Variable Capital Company regime and other fund structures.
	• Private capital markets: Develop private credit to complement PE and VC funding.
	• FinTech: Anchor promising FinTech start-ups in areas like Web 3.0, AI, and green FinTech.
Digitalise Financial Infrastructure	• Bond market infrastructure: Improve end-to-end efficiency in primary bond issuances, listing and settlement processes.
	• Funds settlement utility: Develop an industry funds settlement utility to centralise subscription, redemption, record-keeping workflows, and facilitate reconciliation of fund data flows.
	• SME trade discovery platform (Business-sans-Borders): Launch a digital platform to connect SMEs across growth regions, for trade discovery and easier access to trade financing.
Catalyse Asia's Net-Zero Transition	• Provide greater clarity on transition activities including through the development of an industry-led taxonomy for eight priority sectors.
	• Facilitate the decarbonisation of real economy sectors through appropriate financing solutions.
	• Enhance sustainability disclosures and build data utilities, such as Project GreenPrint.
	• Provide S$100 million grant funding over 2021 – 2025 for climate related purposes.
Shape the Future of Financial Networks	• Expand regional cross-border payment linkages (real-time payment linkages, Project Nexus).
	• Explore potential of DLT in promising use cases (cross-border payments, trade finance, and capital markets).
	• Support tokenisation of financial and real economy assets (e.g. Project Guardian).
	• Enable digital currency connectivity (e.g. Project Orchid).
Foster a Skilled and Adaptable Workforce	• Build workforce competencies in growth areas and provide training support for finance professionals.
	• Develop specialist talent in areas such as sustainability and technology.
	• Develop leaders through opportunities to acquire expertise, international exposure, and networks.

Source: Monetary Authority of Singapore, "MAS launches Financial Services Industry Transformation Map 2025," Media Release, September 15, 2022.

Financial Centres Index) and publishing rankings. And since 2016, the survey has been conducted jointly with the China Development Institute (CDI). Results are announced twice a year, in March and September, with the results of the 34th edition released in September 2023.

In the 32nd edition (September 2022), Singapore overtook Hong Kong to become Asia's top financial center (3rd place overall) (Table 11). The top five positions remained the same in the 34th edition (September 2023), but there were various changes below that. Tokyo, incidentally, had ranked 16th in the 32nd edition but dropped down to 20th place in the 34th edition.

Table 11 Global Financial Centres Index (34th Edition, September 2023)

Ranking	City name	Ranking	City name
1	New York	11	Seoul
2	London	12	Shenzhen
3	Singapore	13	Beijing
4	Hong Kong	14	Frankfurt
5	San Francisco	15	Paris
6	Los Angeles	16	Luxembourg
7	Shanghai	17	Boston
8	Washington	18	Zurich
9	Chicago	19	Amsterdam
10	Geneva	20	Tokyo

Source: Z/Yen Group [2023], p.4.

(ii) What Is an International Financial Center?(14)

When defining an international financial center, the clustering of financial institutions and the volume/value of financial transactions with non-residents (cross-border transactions) are key points. Regarding the clustering of financial institutions, further examination reveals that an "international" financial center handles international products and has a significant presence of foreign individuals and financial institutions among market participants. In other words, in an international financial center, domestic and foreign financial institutions in various areas are present, and they actively engage in global transactions (cross-border transactions).

As for volume/value of financial transactions with non-residents, because an international financial center attracts competitive financial institutions from various countries, this naturally leads to high levels of transactions with overseas entities. These cross-border transactions include banking and securities transactions, and digital financial transactions are expected to increase in importance in the future.

(iii) Why Do Financial Institutions Cluster?

Analyzing existing international financial centers can reveal factors that lead to clustering. That being said, each center has its own unique characteristics, making generalization difficult.

The general view points to the benefits of economies of scale and easy access to information (which is based on the assumption that information obtained through face-to-face interactions is valuable). However, these factors cannot explain everything. Various other specific factors have been pointed out as follows.

The first is the political, social, and economic environment. This means being politically and socially stable, offering a good living environment, having achieved economic growth and reached a certain level of income, and possessing a pool of high-caliber talent who can speak key foreign languages.

The second is the financial system. Economic development and financial development normally go hand in hand, but in order for a city to become an international financial center, its financial sector must be exceptionally developed, large, and sophisticated. And as I have already pointed out, it is important to be able to secure human resources. In particular, consciously developing financial talent and expanding employment in the financial sector is essential, since financial personnel require expertise.

The third is the laws, regulations, and policies that serve as the instruments of government. Financial regulations (including foreign exchange regulations and currency policy), taxation, and accounting systems, which have deep implications for international financial centers, are especially important.

The fourth is physical infrastructure. This includes office buildings, transportation infrastructure, information infrastructure, and natural disaster risk.

And the fifth, which reflects all of the above, is the promotion of the city as an international financial center.

Looking at GFCI's areas of competitiveness (Table 12), almost all of them seem to be included in the factors listed above, and the area of "reputation" may be related to the fifth point above, "promotion." From the viewpoint of the clustering of financial institutions, the key is for financial institutions to accrue substantial benefits from setting

Table 12 GFCI Areas of Competitiveness

Business environment	Human capital	Infrastructure	Financial sector development	Reputation
Political stability and rule of law	Availability of skilled personnel	Built infrastructure	Depth and breadth of industry clusters	City brand and appeal
Institutional and regulatory environment	Flexible labor market	ICT infrastructure	Availability of capital	Level of innovation
Macroeconomic environment	Education and development	Transport infrastructure	Market liquidity	Attractiveness and cultural diversity
Tax and cost competitiveness	Quality of life	Sustainable development	Economic output	Comparative positioning with other centres

Source: Z/Yen Group [2023], p.9.

up in the city, and for this purpose, the second factor mentioned above (financial system), i.e., the presence of a large-scale and sophisticated financial sector, is probably the most important point.

Other factors are related to how smoothly, efficiently, and comfortably financial business can be conducted. Among the other factors, one that is relatively directly related to "benefits" is rising stock prices due to economic growth, which would be included in the first factor above. Another would be preferential treatment for financial transactions through various regulations, systems, and temporary incentives, which is included in the third and fifth factors.

In addition, the city's unique advantages as an international financial center would also be an important factor. Singapore, for example, has been a way station for trade and shipping since the British colonial era (see below), is located in the growing region of Southeast Asia, and is currently a member of the AEC. If it has advantages like these that other cities do not possess, the city concerned is incredibly well-placed to become an international financial center.

(iv) Relationship between the International Financial Centers and Regional Financial Integration

As mentioned above, ASEAN financial integration has been expected to have the effects of (a) making the financial systems of each country more resilient, (b) promoting the economic growth of the countries in the region by streamlining the allocation of funds and financing cross-border transactions within the region, and (c) reducing capital flows from outside the region to limit the risk of double mismatches and financial crises. However, it is necessary to verify whether such effects have actually been obtained. In addition, a drawback of integration has been pointed out, namely that it makes it easier for global financial shocks to spread across the region.

Cross-border transactions are conducted in high volume in international financial centers, and as mentioned above, in Singapore the goal has been to connect global markets, so there are likely to be both positive contributions and adverse impacts in the area of regional financial integration.

(3) History of Singapore as an International Financial Center[15]

Singapore became a British colony in the 19th century and subsequently developed as an important hub for trade and shipping. These economic and industrial sectors are closely related to finance. The financial sector thus expanded, starting with foreign exchange dealing, ship insurance, and shipping and warehousing-related financing.

But Singapore only really started to develop as an international financial center after independence, with the establishment of the Asian Dollar Market (ADM) in 1968. The aim was to take advantage of the need to trade currencies during the hours when the markets in the West were not open. At the same time, an offshore market comprising ACUs (Asian Currency Units: independent bank branches that engaged mainly in offshore currency transactions) was created, allowing foreign banks and financial institutions to participate in the ADM. The ADM laid the foundation for the banking and financial sectors.

From the outset, the Singapore government saw the financial sector not just as a means of supporting other industries, but as a growth industry in its own right. The fact that it developed with the support of the government in the city-state's early years of economic development would prove important for the financial sector.

In the 1980s and 1990s, there was further progression in the internationalization and diversification of Singapore's domestic financial sector. In 1985, against the backdrop of the global trend of economic and financial liberalization, competition with Hong Kong as a financial center intensified. A meeting of the Economic Committee was convened, and the ensuing discussions resulted in the selection of seven growth areas for the financial sector (Table 13).

It was also in the 1980s that the asset management business began to expand in earnest. With Singapore's domestic financial markets continu-

Table 13 Seven Areas of Growth for Singapore's Financial Sector Identified by the Economic Committee in 1985

- Risk management
- Fund management
- Capital markets
- Unlisted securities markets
- Financial and commodity futures
- Markets for the financing of third-country trade
- Reinsurance

Source: Torikoshi [2020]

ing to expand and diversify, asset management has since become the country's main growth sector, helped in part by government incentives.

(4) Overview of Financial and Capital Markets

First, let us look at banks and FinTech companies. As a result of the policy of strengthening the financial industry, various sectors have developed. To begin with, Singapore has become a key banking hub, both regionally and globally. As of December 2023, there were 126 foreign banks operating in the country, compared to just six domestic banks. Of the 126 foreign banks, 30 are Full Banks that can perform all banking operations and 96 are Wholesale Banks with restrictions on retail operations. Banks constitute a growth industry in their own right, and they also contribute to the growth of other industries in a variety of ways, such as by offering trade finance, corporate finance, and infrastructure finance.

Of note is that the country's three largest domestic banks (DBS, OCBC, and UOB) now rank among the world's leading banks. These banks have been expanding into other countries in the region, as well as actively moving into new business spheres in the FinTech and sustainable finance sectors.

As for FinTech companies, MAS announced in June 2015 that it would aim to establish Singapore as a "Smart Financial Centre," in line with the "Smart Nation" initiative that the government had unveiled in November 2014. Subsequently, various measures to promote FinTech, such as the introduction of a "regulatory sandbox," were implemented, and the number of FinTech firms increased significantly. Many of them are also aiming to pursue business outside Singapore in all parts of the region.

Table 14 Daily Average OTC Foreign Exchange Turnover (April 2022)

(Million USD)

Country	Turnover
U.K.	3,754,661
U.S.	1,912,350
Singapore	929,460
Hong Kong	694,359
Japan	432,527
Switzerland	349,742
France	213,730
Germany	183,934
Canada	171,952
Other	1,200,420
Total	9,843,135

Source: BIS [2022], p.1.

Table 15 OTC Foreign Exchange Turnover

(Billion USD, %)

	1992	1998	2004	2010	2016	2022
Singapore	76	145	134	266	517	929
Total	1,115	2,099	2,608	5,045	6,514	9,843
Singapore's share	6.8	6.9	5.1	5.3	7.9	9.4

Source: BIS [2022], p.65.

Second, let us turn our attention to the foreign exchange market(16). Conscious of its location in a time zone where, during normal business hours, the markets in the West are not open, Singapore has been focusing on foreign exchange trading. As of April 2022, the country's market is the third largest in the world after those of the U.S. and the U.K. (Table 14). Its share of the global market has been expanding in recent years (Table 15). Singapore is also eyeing the possibility of establishing itself as an offshore renminbi center.

Third, let us examine Singapore's corporate bond market(17). The majority of corporate bonds are issued in currencies other than the Singapore dollar (S$). Of the S$512 billion worth of outstanding bonds at the end of 2022, 65.0% were denominated in currencies other than the Singapore dollar. In 2022, bonds worth S$190 billion were issued, and the breakdown of this figure by currency is shown in Table 16. In 2022, financial institutions dominated in corporate bond issuance, accounting for 44.3% of the value issued in Singapore dollars and 83.9% of the value issued in other currencies.

In recent years, the issuance of ESG bonds, mainly green bonds, has increased, and in 2022, S$10.1 billion worth of such bonds were issued. MAS aims to make Singapore Asia's green finance hub, with the issuance of green bonds by public institutions driving market expansion.

Fourth, let us look at the asset management business(18). As mentioned above, as early as 1985, the asset management industry was already identified as a potential growth area. According to Torikoshi [2020] (p.100), Singapore recognized its own potential as an international financial center and sought to become an asset management hub like Switzerland and Hong Kong, attracting vast sums of investment capital from around the world as well as its own neighborhood.

Assets under management stood at S$4.909 trillion at the end of 2022, up from S$3.26 trillion at the end of 2017 (the peak figure during this period was S$5.415 trillion at the end of 2021). While 76% of the assets under management is from overseas, 88% is invested overseas, of which half (44%) is deployed in the Asia-Pacific region (Table 17). Singapore absorbs funds from around the world and supplies them mainly to Asia.

It has been pointed out that the background to the steady expansion of Singapore's asset management sector is that wealthy individuals in Asian countries (especially China and Indonesia), which have increased in number due to economic growth, have been providers of investment money.

(5) Factors behind the Success of the Policies

Jie [2017] cites three main factors behind the success of the policy of aiming to become an international financial center.

The first has been the limiting of targets for development to specific sectors. The initial step was the establishment of the ADM. When it was launched in 1968, incentives were also provided. In the same year, for example, the government abolished withholding tax on interest income from non-resident foreign currency deposits. Another example has been the asset management industry. To nurture this sector, tax incentives were provid-

Table 16 Currency Shares of Corporate Bond Issuance in Singapore (2022)

(%)

Currency	Share
U.S. dollar	73.4
Singapore dollar	15.3
Euro	2.6
Hong Kong dollar	2.6
Australian dollar	2.5
Swiss franc	1.5
Philippine peso	1.0
Japanese yen	0.6
British pound	0.2
Other	0.3
Total	100.0

Source: MAS [2023], p.2.

Table 17 Regional Shares of Funding Sources and Investment Destinations of Assets under Management in Singapore

(%)

Region	Funding source	Investment destination
Asia-Pacific ex. Singapore	32	44
Singapore	24	12
North America	19	19
Europe	15	13
Other	10	12
Total	100	100

Source: MAS [2022], p.2.

ed to fund managers, the Singapore dollar was internationalized, and a local currency bond market was developed to serve as a benchmark.

These efforts also had ripple effects, with offshore banking, foreign exchange markets, and futures/derivatives markets developing.

The second has been the approach of drawing up long-term plans for economic and financial sector policies. Committees comprised of government policymakers, private-sector financiers, and academics were frequently established to identify potential growth areas and devise appropriate policies.

For example, as mentioned above, in the 1980s the Economic Committee specified areas such as asset management, capital markets, and derivatives as growth spheres, and these subsequently became driving forces behind the growth of the financial sector. More recently, the Committee on the Future Economy has identified FinTech as an area where Singapore can become a world leader, and has proposed policies such as 1) developing the country as a Smart Financial Centre to increase the efficiency of electronic payments and 2) strengthening financing for Asian startups and SMEs.

The third has been joint development of policies by numerous stakeholders. Input from private-sector financiers, researchers, independent experts, and others has been utilized to ensure that appropriate policies and regulations are implemented. Besides formal committees, there have been informal, ongoing consultations, and these have proved effective.

As a result, in addition to policy objectives, the interests and constraints of the private sector have also been reflected in the policies. This approach has been consistently adopted since the earliest days when the ADM was launched.

(6) Supplementary Information on Singapore's Policy

(i) Self-perception of Singapore's Attractiveness

I have already given five reasons for the clustering of financial institutions in Singapore. Regarding this point, in November 2016, MAS highlighted three factors that make the city-state attractive(19). The first is an environment conducive to business (regulations and tax incentives), the second is low costs and the presence of excellent infrastructure for business (e.g., low-rent offices, efficient public transport, advanced ICT infrastructure, and free trade agreements (FTAs)), and the third is the abundance of skilled personnel. Human resources are the most critical factor, and MAS has been focusing on developing financial personnel by offering various programs such as the Financial Sector Talent Development Scheme.

(ii) Singapore's Financial Sector Policy

The characteristics of the Financial Services ITM discussed earlier can be summarized as follows: (1) Global: Emphasis on asset management sector (including wealth management) and the foreign exchange market. (2) Regional: Focus on financing and risk management for Asian companies. (3) General: Focus on innovation, which has become increasingly important in recent years, and ongoing emphasis on financial human resources as the biggest attraction. And for Financial Services ITM 2025 (Table 10), an addition was made: (4) Transition to net zero.

Promotion of the asset management industry and the foreign exchange market coupled with a focus on human resource development have been a constant since the 1960s. And the rapid technological progress of recent years has been added as a new driver. Sustainable finance is another new element.

In addition, on its website (https://www.mas.gov.sg/development), MAS explains to domestic and foreign financial institutions the financial sector policies aimed at making Singapore an international financial center. The information provided includes 1) details of development support policies for each financial business area, 2) details of FinTech innovation-related policies aimed at making the country a Smart Financial Centre, 3) details of incentives for financial institutions considering setting up or expanding in Singapore (grants and tax incentives for financial institutions, support for smaller financial institutions and FinTech startups, etc.), and 4) details of policies related to financial human resources (support for hiring, training, and career development of financial personnel). The site also offers a comprehensive guide for financial institutions thinking about setting up in Singapore on how to get their operations up and running, as well as an overview of financial regulations and guidance (https://www.mas.gov.sg/development/why-singapore).

(iii) Rating in the Global Financial Centres Index

Singapore's ranking by industry sector is shown in Table 18, and reflecting the nature of its policy initiatives, it ranks especially high in asset management, professional services, FinTech, and trading. In the past year, Singapore has been mentioned 61 times as a city that is expected to become more important in the future among financial centers, putting it second only to Seoul, which has 176 mentions. This is indicative of Singapore's strong reputation among financial professionals[20].

6. Implications for Japan of Financial Sector Challenges in ASEAN Countries

(1) Goal of Becoming an International Financial Center

Japan has frequently espoused policies aimed at enhancing its status as an international financial center. Even now, for example, in the government's Doubling Asset-based Income Plan, which was announced in November 2022, the sixth pillar is "realization of an international financial center open to the world," and to that end, the government will comprehensively promote 1) revitalization of financial and capital markets to contribute to new growth, 2) globalization of financial administration and tax systems, and 3) improvement of the living and business environment to support highly skilled foreign workers and the effective dissemination of information.

To accomplish the first task (revitalization of financial and capital markets), the following steps are to be taken: 1) support for startups, 2) stimulation of the ESG bond market, 3) investment in human capital, 4) corporate governance reforms, 5) enhancing market infrastructure (private trading systems and reduction of investment units for listed companies), and 6) revision of regulations on firewalls between banks and securities companies. In order to achieve the second goal (globalization of financial administration and tax systems), leveling-up of markets and administration, public relations to emphasize ambitions as an international financial center, support with the establishment of branches by overseas financial institutions, and tax system reform are among the steps to be taken. Regarding the third item (improvement of the living and business environment to support highly skilled foreign workers), a detailed breakdown of the action to be taken was not provided.

Next, in November 2021, the Tokyo Metropolitan Government announced the "'Global Financial City: Tokyo' Vision 2.0: Realizing a Sustainable Recovery and Working Toward Becoming a World-Leading Global Financial City," which called for 1) establishment of a robust financial market that helps solve social issues, 2) digitaliza-

Table 18 Singapore's GFCI Ranking by Industry Sector

Banking	Investment management	Insurance	Professional services	Government & regulatory	Finance	FinTech	Trading
6th	3rd	4th	2nd	4th	8th	3rd	2nd

Source: Z/Yen Group [2023], p.11.

tion of finance through the utilization of FinTech, and 3) attracting a wide range of asset managers and other diverse financial players. These measures are based on the following concepts: 1) expansion of green products and other sustainable finance-related financial products and ESG projects as receptacles for investment, 2) promotion of the digitalization of finance as infrastructure, and 3) accumulation of players who can serve as "fund connectors."

Conducting a detailed evaluation of these policies is not easy, but I will make some comments with comparisons with Singapore in mind. First of all, although there is nothing wrong with the specific individual measures, it would seem necessary to further deepen discussions on a long-term vision of how the financial system should be shaped if finance is regarded as one of the industries that can support Japan's economic growth in the future. The conventional, basic approach is to emphasize the scale of personal financial assets in Japan, which reached 2,121 trillion yen at the end of September 2023, and position the asset management industry at the center. This is a rational way of thinking, but a broader discussion on the financial system as a whole would seem to be needed.

In addition, if Japan is to become an international financial center, it will naturally need to place greater emphasis on ASEAN countries, given that strengthening economic relationships will be essential.

Besides aiming to establish bases for financial institutions such as asset managers, it will also be important to implement policies to promote cross-border transactions. Cross-border transactions between Japan and ASEAN countries need to be considered bidirectionally (Table 19).

Challenges for the Japan market include the development of the market, modification and harmonization of various systems (particularly relaxation of related regulations and enhancement of effectiveness, efficiency, and transparency), public relations activities related to the Japan market, and strong policy commitment behind it. As an extension of public relations initiatives, policies to attract bond issuance and stock listing by Asian companies and encourage investment by foreign investors could be deployed.

Table 19 Factors Affecting Cross-border Financial Transactions

(1) Macroeconomic Conditions
• conomic and political stability • integration of real economy • development of financial markets • market confidence
(2) Investment Factors
• market liquidity • risk-return profile (investment return, market stability, credit risk) • availability of investment opportunity • market size • asset correlation
(3) Structural Factors
• development of market infrastructure • availability of market information • economic openness (capital controls) • presence of trading barriers • laws and regulations (tax treatments) • governance (transparency, disclosure standards)

Source: Asian Development Bank, *Asia Bond Monitor*, April 2012, pp.41-51.

Undeniably important factors for elevating Japan's status as an international financial center are 1) depth of companies and retail investors in the Japan market and 2) infrastructure such as transportation, language capabilities, and human resources. Regarding 1), this is ultimately a matter of the attractiveness of the Japanese economy and market, which means that the market will not necessarily expand simply with the improvement of institutional factors. This point relates to the business growth potential of the financial institutions that have entered the market. Business growth potential is an indispensable prerequisite for aiming to become an international financial center. As for 2), the issue of language is also part of the market infrastructure, such as which languages can be used in documentation.

(2) Promoting Japan as a "Leading Asset Management Center"

The "leading asset management center" concept was clearly mentioned in the Basic Policy on Economic and Fiscal Management and Reform 2023 as well as the Grand Design and Action Plan for a New Form of Capitalism 2023 Revised Version, which were both announced in June 2023. According to the latter, improving the investment capabilities of asset management firms and asset owners is essential to increase returns to households and to encourage greater investment. It also states the goal of "bringing Japan's asset management sector to a world-class level," which is related to the goal of becoming an international financial center.

In December 2023, the Policy Plan for Promoting Japan as a Leading Asset Management Center was unveiled by the government. The goal is to improve the entire investment chain, which comprises various stakeholders in asset management. A raft of policies have already been implemented, but this plan aims to further strengthen them.

The plan's first specific measure is "reforming Japan's asset management sector," which involves "enhancing the asset management capabilities and improving the governance of major financial groups" and "promoting new entry of domestic and overseas firms into the asset management sector as well as competition." The latter includes 1) rectifying Japan's unique business practices and removing barriers to entry, 2) establishing special zones for financial and asset management business (clustering of financial and asset management services), and 3) introducing a new program to support new entrants (Japanese EMP: Emerging Managers Program[21]).

The second specific measure is "reforming asset ownership in Japan," and includes "developing 'Asset Owner Principles'" and "reforming corporate pension funds." Regarding the former, a set of common principles will be drawn up by the summer of 2024. The latter includes 1) reforming defined benefit corporate pension plans (DBs), 2) reforming defined contribution corporate pension plans (DCs), and 3) further promoting private pensions, including corporate pensions. With DBs, improving asset management capabilities is among the tasks. As for DCs, the tasks include improving the framework for appropriate product selection.

The third specific measure is "promoting financing for growth and diversifying investment opportunities," which includes "promoting investment in startups with growth potential" and "diversifying investment opportunities, including alternative investments and sustainable investments."

The fourth specific measure is "effective implementation of stewardship activities" and entails promoting effective engagement between investors and companies.

And the fifth specific measure is "strengthening public relations and communications." This will involve disseminating information on the attractiveness of the Japan market and launching an "Asset Management Forum."

In addition, although not included in the current plan, various policies related to households (fundamental expansion and perpetuation of the NISA scheme, promotion of widespread use of financial advisors, improved education in finance and economics, etc.) and policies for financial product distributors (ensuring that they conduct business from the perspective of customers) are also regarded as important.

As is the case with ASEAN countries, diversifying the population's investments and raising standards in the asset management industry will be vital from the perspective of improving people's lives and enabling Japan's economy to grow, so such policies are essential. At the same time, it is crucial that this policy be viewed as something that will enhance Japan's status as an international financial center and that enthusiasm for working to establish the country as a leading international financial center be demonstrated over the long term.

(3) Cooperation with and Participation in ASEAN Countries' Initiatives

(i) Required Cooperation and Participation of Japan

Going forward, Japan should place importance on its relations with ASEAN countries when designing various financial sector policies. To this end, Japan will need to contribute in whatever ways it can to the various multilateral initiatives described in this paper, and also provide bilateral support tailored to the respective needs of the countries receiving this support.

And when doing this, Japan must cooperate extensively in tackling the challenges listed in Table 1. Among those challenges, regional financial integration has the potential to provide financial stability to each of the countries, and by financing or facilitating cross-border transactions within the region, there is the potential for the ripple effects of progress with financial inclusion, enhanced convenience, stronger economic growth, and improved personal well-being.

In addition, a large number of Japanese companies and financial institutions have set up operations in ASEAN countries, so improvements in the financial systems and financial regulations of these nations will be of great benefit to Japan's business entities. And if overseas portfolio investment is included, the interests of institutional and retail investors in Japan will also be served. Deepening relations between Japan's various business entities and ASEAN countries can be expected to serve the interests of both Japan and ASEAN countries, creating a virtuous cycle that further enhances the relationship. It will be necessary to provide policy support for this trend.

In addition to providing experience, knowledge, and technology, it will also be important for Japan to participate in ASEAN financial integration and aim for coexistence with ASEAN countries. Japan's economy is beset by concerns about contraction due to the declining population, so promoting not only inbound tourism but also inward investment is critical. To this end, it is vital that Japan shore up its economy and its companies to make them more attractive to investors, and raise the level of its domestic financial system by strengthening its financial talent base. These points also relate to what I wrote in the Singapore section about factors that support the establishment of international financial centers.

In addition, Japan's vast pool of personal financial assets is one of the country's strengths, so it should also be possible to expand outward investment by individuals as a component of cross-border financial transactions. To improve the ability to cope with the increased sophistication of such transactions, the anticipated intensification of competition in the domestic financial market, and the increasing sophistication and complexity of the financial system, an essential task will be to strengthen financial and digital education for individuals, SMEs, and the elderly.

An example of efforts to foster coexistence (i.e., greater economic integration) with ASEAN countries is an initiative to link digital payment systems. The Ministry of Economy, Trade and Industry (METI) is exploring the potential for interoperability between Japan's unified standard for QR code payments (JPQR) and the unified standard for QR code payments in Southeast Asian countries. In December 2022, METI and Bank Indonesia signed a document called the "Memorandum of Cooperation (MOC) between the Ministry of Economy, Trade and Industry of Japan and Bank Indonesia on Cooperation in the Area of Unified QR Code-Based Payments."

And in June 2023, the Financial Services Agency (FSA) announced that it would participate as an observer in Project Guardian, a public-private partnership initiative on digital assets launched by Singapore's MAS in May 2022.

Furthermore, in the area of CBDCs (Central Bank Digital Currencies) and digital currencies, action in the private sector is gaining momentum. Soramitsu Co., Ltd., a Japanese FinTech company, is pursuing a project to create cross-border payment systems for Asian countries. In Cambodia, Soramitsu has built a system called Bakong, which went into operation in October 2020. The system handles digital payments using QR codes and now allows cross-border payments to be made between Cambodia and Malaysia, Thailand, and Vietnam. And in February 2023, Soramitsu signed an agreement with the Bank of the Lao P.D.R. (central bank of Laos) to begin a CBDC proof of concept. The hope is that in the future the system will provide another means of cross-border settlement with Asian countries. In November of the same year, the company announced that it would also be participating in a proof of concept ahead of the introduction of a CBDC in the Solomon Islands.

Soramitsu is also attempting to create a stablecoin exchange in Japan, and is considering using this to enable cross-border payments involving CBDCs in Asian countries. The company intends to work with Japanese banks and other entities to build the necessary infrastructure. In Japan, the Payment Services Act was amended in June 2023 to allow banks to issue stablecoins. This revision of the law will be a plus for the exchange that Soramitsu is aiming to open. By building cross-border payment systems that use CBDCs and stablecoins, Soramitsu hopes to support expansion of Japanese SMEs into Southeast Asia.

(ii) Importance of Cooperation

As Vatikiotis [2023] points out, the raison d'être for ASEAN as an organization is also being questioned as global divisions deepen, with the U.S.-China conflict the central theme of this trend. In this context, cooperation to address financial issues needs to be viewed as contributing to the strengthening of relations between countries.

This paper has not delved very deeply into the financial stability aspect, and has not covered the CMIM mechanism in detail, but Gao [2023], for example, discusses the strengthening of the ASEAN+3 regional financial cooperation framework, including CMIM and AMRO, from China's point of view. China is also cooperating with ASEAN countries in the area of finance via its own framework, and has also been working continuously to internationalize the renminbi. Against this backdrop, Japan should continue to actively participate in the ASEAN+3 regional financial cooperation.

Conclusion

This paper has summarized the challenges faced by the financial sectors of ASEAN countries, examined multilateral initiatives and national policies to resolve them, and considered the question of what Japan, which has actively engaged with the ASEAN region since the 1997 Asian financial crisis, should do going forward.

Japan ought to continue to play a central role in initiatives for regional financial cooperation such as ASEAN+3. The hope is that it will continue to contribute experience, knowledge, and technology to facilitate ASEAN financial integration. As for bilateral cooperation, it will be important for Japan to be forthcoming with appropriate support to meet the needs of partner countries.

Currently, Japan is aiming to elevate its status as an international financial center and beef up its asset management sector (establish itself as a leading asset management center). With these initiatives, too, it is vital that it emphasize the reinforcement of relations with ASEAN countries. Increase of cross-border financial transactions between Japan's various business entities and ASEAN countries, and expansion of branches and operations by Japanese and ASEAN financial institutions in each other's countries can be expected to enhance Japan's reputation and lead to the creation of a virtuous cycle.

The financial industry has the potential to become one of the driving forces in Japan's economic growth in the future, making it essential to devise a long-term vision and work on achieving it. In addition, deepening financial connections with ASEAN countries is important in various respects. The hope is for an expansion of effective initiatives in the future.

End Notes

1. Regarding ABMI, see also Shimizu [2014] and Shimizu [2018].
2. For related literature on climate finance, see Shimizu [2021].
3. Based on ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting [2023a], [2023b].
4. From ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting [2023a].
5. Refers to ASEAN+3 Finance Ministers' and Central Bank Governors' Meeting [2023b].
6. A 20-character, alpha-numeric code based on the ISO 17442 standard developed by the International Organization for Standardization (ISO). It connects to key reference information that enables clear and unique identification of legal entities participating in financial transactions (this explanation is from the website of the Global Legal Entity Identifier Foundation (GLEIF), established by the Financial Stability Board in June 2014 to support the promotion and use of LEIs).
7. Referred to Katayama [2017].
8. For related literature on ASEAN financial integration, see Shimizu [2016].
9. The description that follows relied greatly on Fukuchi [2021]. Also referred to Phoebe [2022].
10. The AFAS is a positive-list framework that is scheduled to be replaced by the ASEAN Trade in Services Agreement (ATISA), which is a negative-list framework.
11. Referred to Asian Development Bank [2023] p.103 et seq.
12. Statements on trade are from Asian Development Bank [2023] pp.107-108.
13. From Asian Development Bank [2022] p.92 et seq.

14. In the following, referred to Torikoshi [2020].

15. In the following, referred to Jie [2017].

16. Referred to BIS [2022].

17. Referred to MAS [2023].

18. Referred to MAS [2022].

19. In the following, referred to Jie [2017] p.11 et seq.

20. Referred to Z/Yen Group [2023] p.6.

21. Program for asset owners to discover emerging asset managers and provide money to their funds.

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