



# 39<sup>TH</sup> ANNUAL MEETING

## BOARD OF GOVERNORS

ASIAN DEVELOPMENT BANK

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**GS-16**

### **HONG KONG, CHINA**

**Peter ST Pang**, Head of Delegation

Let me first thank the Government and the people of India for their warm hospitality in hosting this year's Annual Meeting. I must also thank management and staff of the Asian Development Bank (ADB) for the excellent arrangements made, and join other Governors in welcoming our new members—Armenia and Brunei Darussalam.

The economic growth in Asia over the past few decades has helped reduce poverty dramatically and brought better lives to hundreds of millions of people. While we are now experiencing one of the fastest growth periods in this region, we must not be complacent. Rather, we should seek to achieve a more balanced and sustainable trajectory and to mitigate any risks that may hamper our growth prospects.

Underpinning Asia's rapid growth are the much closer economic and trade relationships among regional economies, which have far outpaced integration on the financial front. While more than half of total trade in Asia is intra-regional, capital flows mainly involve major markets outside the region. Currently, a sizable portion of gross savings in Asia finds its way into the financial obligations of the developed markets before it is recycled back to Asia in much more volatile forms. Such an asymmetric development in economic and financial integration not only hinders economic growth from achieving its full potential, but it may also lead to financial instability in the region. We all have fresh memories of the disruptive impacts of the Asian financial crisis.

There is little doubt that a higher degree of financial integration would facilitate increasing intra-regional economic and trade activities, and enhance our resilience against volatile international capital flows. What would be the most appropriate strategy to achieve higher financial integration in Asia? One might think that financial integration in the region could only be pursued when the final goal is clearly defined as some form of economic or monetary union, and that such a goal would have to be unanimously agreed upon by all members. This is, in my view, not necessarily the case. There are areas of financial integration worth pursuing in their own right, and these could form the building blocks for a higher form of economic and financial cooperation in the future.

I can think of five areas of financial integration under the building block approach. The first is the linking of financial infrastructure, i.e., the trading, payment, clearing, settlement and custodian systems, across jurisdictions. This would facilitate the safe and efficient flow of funds between jurisdictions arising from the many trade, investment and other economic transactions taking place every day.

The second area concerns the relaxation of restrictions on access by foreign financial intermediaries to domestic financial markets. Currently, high quantitative licensing thresholds imposed by many jurisdictions in the region have kept financial institutions of neighboring economies away. However, size is not necessarily a good indicator of financial soundness and other objective measurements such as capital adequacy should be used instead.

The third area is the harmonization of financial standards within the region. This specifically means the adoption of minimum international standards while striving to achieve best international practices, rather than the development of regional standards that are different and therefore inevitably risk being seen as inadequate. This would help enhance investors' confidence and attract a greater proportion of the abundant Asian savings to stay in the region.

The fourth area concerns cooperation between jurisdictions in developing domestic financial systems. I am glad to see that Asian governments have put in place several initiatives in this regard. A good example is the Asian Bond Markets Initiative under the Association of Southeast Asian Nations (ASEAN)+3 forum with the strong support of ADB. Another successful example is the launch of the Asian Bond Fund by the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which has provided an excellent example of regional cooperation in debt market development and a promising precedent for future cooperative ventures.

The fifth area concerns the promotion of greater cross-border capital flows. The freer mobility of capital is essential to achieve greater efficiency in the allocation of financial resources. While there are obviously risks associated with financial liberalization, these risks are to be managed, not avoided. With foreign reserves at very high levels, it may be an opportune time for the regional jurisdictions to embark on prudently organized financial liberalization. The qualified domestic institutional investor (QDII) scheme announced recently by the People's Republic of China, allowing outward portfolio investment to be conducted in an orderly manner, is a welcome move.

The five areas of financial integration that I have just discussed would help enhance the efficiency of financial intermediation and promote greater financial stability of the region, thus contributing to more sustainable growth. As we proceed further under the building block approach, we will probably identify and achieve other areas of financial integration, and thus a higher quality of growth. I am glad to note that ADB also shares this view of the importance of economic and financial integration to the region and has been gearing up its efforts to promote integration of trade, investment, and finance in the region. With the collaborative efforts of the regional economies, I believe we should be able to achieve more balanced, stable and sustainable growth.