



BOOK REVIEW

Capital Market Reform in Asia: Towards Developed and Integrated Markets in Times of Change

M. Kawai, A. Sheng (Eds.), SAGE India, 2012, 396 pp. Rs 995.

Capital Market Reform in Asia is a set of articles based on papers presented at the OECD-ADBI Annual Roundtable Conference on Capital Market Reform.

The timing could not be more perfect for evaluating a book with suggestions on how to avert a financial crisis, especially for Asian countries. Most Asian countries had already learnt in the late 1990s that an excessive courting of foreign capital, especially in the form of short-term debt, to stimulate growth without developing local institutions and markets is a recipe for disaster. After more than a decade, it appears that these economies haven't learnt their lessons well.

The US Fed's quantitative easing following the 2008 global financial meltdown had provided cheap capital to many emerging economies, including Asian countries such as India, to finance their burgeoning deficit. This over-reliance on foreign capital is coming back to haunt the Asian countries once again. Economic recovery in the US and Japan is set to suck out this foreign capital leaving Asian countries exposed to instability once again. Since May 1 of this year, emerging markets, many of which are in Asia, have seen their currencies plunge by 10–20%.

Though the outcome appears similar, there is one key difference between what happened during the 1997–98 Asian crisis and now. Economies then had to devalue their currencies in a big way to reflect currency flows as their currencies were pegged to the dollar. Today, these economies have floating exchange rates where market participants price the intrinsic value of the currency real time. While this has helped these economies to some extent, the root cause of their vulnerability still remains: they depend too much on foreign capital to finance their growth and deficit.

Many of the Asian economies still do not have a vibrant capital market to help channelise domestic savings which, incidentally, is among the highest in the world. Regulation

is inconsistent and regulatory capture by vested interests is common. The two big countries in the region, China and India, have faced numerous market-related scandals in recent years hurting investors' trust in financial markets. For some countries like India, the domestic markets have been practically held hostage by foreign flows causing high volatility.

So it is with great interest that I started reading this book to learn what the synthesised wisdom was following the first 1997–98 Asian crisis. However, the book was disappointing, both in presenting that wisdom, and in being able to provide a coherent set of suggestions that can work well in Asian countries.

The Organisation for Economic Cooperation and Development (OECD) and Asian Development Bank Institute (ADBI) joined hands soon after the 1997–98 crisis to brainstorm ways to build and reform the capital markets in the region. Their annual roundtable brought academics, policy makers and industry experts, both from the region as well as from the rest of the world, to discuss ideas and to learn from one another. This book is an edited compilation of presentations made at this roundtable. Though the context was the backdrop of the 1997–98 crisis, the authors also highlight the changes in the thinking brought about by the 2008 financial crisis.

The chapters in the book are loosely organised into four broad themes: the state of development of capital markets in Asia, issues in capital market reforms, emerging risks and challenges of supervision and governance, and finally on the need for regional cooperation and integration of capital markets in Asia. Though the themes seem logically connected, the individual chapters themselves follow no set pattern, and range from being prescriptive (like the chapters on corporate governance and investor protection) to being descriptive (like the chapters on non-tradable share reform in China and reforms in Malaysia). Some chapters examine issues through a local lens (like the chapter on new financial market structure for East Asia) while others provide an overview from a global lens (like the Chapters on IOSCO perspective on Corporate Governance and on Best Practices in Shaping Government Securities Markets). They cover issues and progress in different markets such as equity and bond markets as well as the role played by the banking sector in these economies. Most of the authors come from a regulatory paradigm that, at best, can be described as the Western approach that relies on building institutions that act as checks and balances on one another under the broad umbrella of a market-oriented economy.

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As I started reading the book, the thing that struck me first is the paradox that Asian countries pose – while they are clearly similar in some respects, they are quite disparate in some others – to policy makers and regulators. This paradox made me think: Why should we consider the geographical construct (“Asia”) as our point of reference to study capital market reforms? Shouldn’t we use political ideology or the state of legal institutions or even the degree of export orientation, as the homogenising factor to group countries, as they play a far more important role in the success or failure of capital market reforms than geography? To illustrate my point, the chapter on the “Non-tradable share reform in the People’s Republic of China,” highlights the crucial role played by the Communist Party Leadership in getting political consensus that, until then, was unreachable for the Chinese securities market regulator. Such an approach, through high-level diktat, would not work in other Asian countries such as India that rely on a democratic process. If that is the case, the question arises as to what valuable lessons we learn from the Chinese experience? My guess is – very little.

Given this paradox, it would have been interesting to examine more closely the choices made by different countries to overcome regulatory and institutional constraints that could help others in a similar state. Unfortunately, the book explores only a few of them. The Chinese example mentioned above typifies the challenge posed in privatising public firms, something that every emerging economy faces today. Another chapter on the Malaysian capital market reforms highlights the role played by a long-term vision (the 10-year Capital Market Masterplan) that laid a strategic roadmap for developing institutions within a strong regulatory framework. The success of this effort can best be seen in the universal

growth across all major market segments (stocks, bonds and derivatives) that other countries such as India have been struggling to achieve (The Indian corporate bond market is largely undeveloped and its speculative derivatives market attracts nine trades for every one trade in the underlying cash market). Interestingly, Malaysia also has been able to develop and manage its Sharia-compliant market products alongside traditional products – which could have lessons for Islamic nations. However, there is little discussion in the book on how they were able to manage that.

Moreover, some major issues that constrain capital market development such as the domination of family owned firms in garnering capital and credit, failure to develop sustainable retirement planning through capital markets, inability to break domestic investors’ preference for “safe” products such as bank deposits, real estate and gold etc. do not figure in this compilation. Institutional impediments unique to Asian economies such as lack of transparency, arbitrary enforcement and political control have also not been given attention. Instead, several chapters are devoted to regulatory responses in the developed economies following the 2008 financial crisis, which though useful, are not first order issues for the Asian economies.

Overall, the book is a decent collection of responses and suggestions meant to stimulate capital market growth that is more generic than specific to problems facing Asian economies.

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