

OECD/ADBI 7th Round Table on Capital Market Reform in Asia

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SESSION 1: FINANCIAL POLICY LANDSCAPE

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Financial Sector Regulation: Lessons So Far.

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Douglass North

- “Economists of the libertarian persuasion have for some time laboured under the delusion that there is something called laissez-faire and that once there are in place “efficient” property rights and the rule of law, the economy will perform well without further adjustment”

Layers

- Black-letter law
- Self regulation
- Informal understandings

- Rules made in the wrong “jurisdiction” will be inefficient and probably ineffective

The front-line regulator.

- Constantly under attack by individuals in the market who claim disadvantage.
- But their own interest is to maintain their franchise – i.e. a well-functioning market

- Front-line supervisors are under pressure to hand back responsibility to the official regulator, who may be quite willing to receive it.

Pressures for making regulation uniform

- Presumption that all that is needed is a well-functioning market and clear property rights

Focus on:

- Anti-competitive behaviour
- Market misconduct
- Asymmetric information
- Systemic instability

- Re-focus on market failure and away from the health of individual institutions

But what about the special characteristics of BANKS?

- Fixed nominal liabilities
- Non-marketable assets

Basle II

- Risk-focus
- Complex supervision
- Market surveillance

- Prompt Corrective Action
- Deposit Insurance

Unitary Supervision?

- “banking supervision in developing countries has been rather better done if taken under the wing of the central bank”
(Goodhart)

Emerging Financial Markets

- Susceptible to regular crises (macro vulnerability)
- Banks **WILL** be bailed out
- Prompt Corrective Action will not be prompt enough
- Deposit insurance is **NO PROTECTION** against bank runs

- Shortage of Administrative capacity
(scarce governance capability)
- Basle II relies on market risk
assessment: usually not available in
emerging markets

- Which regulator has the capacity and independence?
- What is the best CO-ORDINATING framework?
- Will regulatory arrangements widen the tax-payer funded safety net?

- Risk differentiation between institutions is **DESIRABLE** and should not be muted.
- Caveat emptor should be preserved.