

On the Asian bond market: comments on Barry Eichengreen and Pipat Luengnaruemitchai's paper "Why doesn't Asia have bigger bond markets?"

Junggon Oh¹

The main arguments of the above paper are as follows: causes of the underdevelopment of the Asian bond markets include small economic size, poor legal systems, risky investment environments, weak corporate governance and insufficient transparency, low levels of economic development, less developed banking systems, inappropriate interest rate and exchange rate policies, and capital controls. Results of empirical tests using panel generalised least squares (GLS) on data for 41 countries for the period of 1990-2001 support this general hypothesis.

An important finding in this paper is to show empirically the existence of complementarities between banking sector and bond market development. It is necessary to stress again the importance of the banking sector in the period of transition from a bank-centred financial system to a market-centred one after the East Asian crisis, because the sector contributes to a decrease in information asymmetry and transaction costs through long-run close relationships with customers, etc.

There is a hierarchy of external finance in the financial system. The share of bank credit is the largest among external financing sources in most countries mainly because transaction costs and information asymmetry are relatively low in the banking sector (Table 1).

Table 1
Composition of external finance
2001, in per cent

	Bank credit	Stock market capitalisation ¹	Outstanding domestic bonds
Emerging markets	50.74	31.98	17.28
Asia	54.90	31.45	13.65
Latin America	38.24	35.91	25.85
Central Europe	47.69	18.01	34.30
Developed Countries	45.92	29.08	25.01
United States	39.60	33.91	26.50
Japan	59.17	17.65	23.18

¹ Stock market capitalisation is not exactly equivalent to the amount of finance obtained through the stock market.

Source: Eichengreen and Luengnaruemitchai (2006).

¹ The views expressed herein are those of the author and do not necessarily reflect those of the Bank of Korea.

In order to develop the bond market, infrastructure development and the introduction of legal requirements in areas such as information disclosure, accounting standards, credit ratings, etc, are necessary in order to reduce transaction costs and information asymmetry. A competitive banking system can also reduce information asymmetry and transaction costs through long-run close relationships with customers and can thereby contribute to the development of the bond market.

However, there are some points to be discussed regarding this paper: Are conclusions specific to Asia or general to all regions? Can empirical tests for Asia only, rather than for 41 countries, obtain the same results?