FDI in the Financial Sector: The Experience of ASEAN Countries Over the Last Decade

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Executive Summary

ASEAN countries have historically relied on foreign direct investment as an important part of their industrialization and export-led growth. Yet FDI in the financial sector before the Asian financial crisis was relatively muted, because of considerable restrictions on FDI in the financial sector, particularly the banking sector. These restrictions were relaxed or removed altogether post-crisis, with the exception of Malaysia, which led to a significant rise in foreign bank participation and market share. Foreign bank share of total banking assets in Indonesia and Thailand for example have doubled since the crisis.

The experience of ASEAN suggests that the severity of the financial crisis had little to do with banking liberalization per se, and more to do with capital account liberalization and weak domestic banking systems. Thailand and Indonesia had very low rates of foreign bank participation before the crisis but were hit the hardest; the opposite is true for Singapore. There is moreover some evidence, although not conclusive, to suggest that foreign bank presence may have helped to stabilize the banking system. Lending from foreign bank branches in Thailand and Singapore rose sharply during the crisis, and NPL ratios for foreign banks were significantly lower than the local banks.

[1] The views expressed represent that of the author and not that of the Monetary Authority of Singapore.

ASEAN countries, on the whole, appear post-crisis to be more open to banking liberalization, and weary of capital account liberalization. Malaysia, Indonesia and Thailand have introduced capital controls to varying degrees since the crisis, in contrast to the trend of financial sector liberalization. These policy shifts and increased foreign bank presence locally have led to a significant rise in direct lending from locally-based foreign banks, and a fall in cross-border lending. In Malaysia and Thailand, local claims have already exceeded international claims of BIS reporting banks. We expect foreign participation in ASEAN's financial sector to continue growing quite rapidly over the next decade, especially in Indonesia, due to significantly lower restrictions, higher demand for foreign capital and expertise, and the relatively small presence to begin with as compared to Latin American and Central European economies.

Non-Japan Asian banks are emerging as major players in East Asia, including Southeast Asia. Japanese banks were the traditional Asian source of lending to and investment in Southeast Asia's financial sector, but more recently, non-Japan banks have been acquiring stakes and expanding their presence. This includes Singapore, Hong Kong, Taiwanese and Malaysian banks.

Banking liberalization has led to mixed incomes: Thailand has benefited from a surge in FDI but Indonesia has had much less success. Liberalization has also led to the occasional political backlash, as foreign bank competition is often seen, misguidedly, as the cause of local bank retrenchments and consolidation. Liberalization has also pushed governments to assess "level-playing field" policy issues related to deposit insurance, basic banking services, and corporate governance – gaps which did not profile as starkly in a local bank dominated system.

1. ASEAN countries have historically relied on foreign direct investment as an important part of its industrialization and growth. Over the last decade, FDI accounted for almost all of total gross capital inflows to ASEAN. The experience with direct investment is that it is much more stable compared to bank lending and security investments.

2. More recently, FDI flows to ASEAN, both as a share and in absolute terms, have been declining. Total FDI flows to ASEAN-5 in 2001 for example was only US$10.9 billion in 2001, about 58 percent less than the peak of US$25.7 billion reached in 1997. The drop is especially severe for Indonesia. China, on the other hand, is enjoying an increasingly larger share of FDI flows, securing US$44.2 billion in 2001. ASEAN countries as a result are under significant pressure to raise the incentives for foreign direct investment, including the liberalization of its financial sector.

Table 1: Foreign Share of Domestic Banking Assets in East Asia, 2001

	Country	Share of Total Banking Assets	$US Billion
Southeast Asia	Singapore	44.4	92.2
	Philippines	18.2	59.7
	Malaysia	24.8	34.6
	Thailand	17.6	25.5
	Indonesia	10.4	10.4
	Southeast Asia	***24.2%***	***$222.4***
Northeast Asia	Japan	6.5	399.2
	Hong Kong	38.0	300.1
	South Korea	8.1	37.6
	Taiwan	6.5	36.5
	China	2.1	45.2
	Northeast Asia	***8.3%***	***$818.6***
TOTAL	***EAST ASIA***	***9.6%***	***$1,041.0***

Source: CEIC, central bank websites, KPMG Banking Survey Report 2001, Hong Kong and Macau.

3. Table 1 summarizes the foreign share of banking assets in the East Asian economies. We highlight several observations. First, foreign-controlled banking assets of East Asian countries amounted to about US$1 trillion, a sizeable amount. East Asia ex-Japan alone is about US$600 billion, significantly higher than the US$400 billion in Latin America and US$150 billion in Central Europe. Second, foreign share of banking assets in Southeast Asia, at about 24.2% in 2001, is far larger than the foreign share of banking assets in Northeast Asia, at 8.3%. ASEAN countries on the whole are significantly more open than the Northeast Asian economies.

3. Third, the two offshore financial centers of Singapore and Hong Kong have a significantly higher foreign presence because of their history as British colonies, their open and large offshore financial centers, and the large foreign participation in their financial markets. These two financial centers account for about two-thirds of East Asia ex-Japan foreign bank assets.

4. There is nevertheless a discernible trend across most of the East Asian economies in terms of foreign bank presence and participation in the latter half of the decade. Foreign participation in ASEAN's banking sector in the first half of the 1990s was largely stable or grew only modestly, with perhaps the exception of Thailand because of the introduction of the BIBF during this period.[2] Substantial restrictions on foreign bank entry and expansion - including restrictions on foreign equity, number of branches and ATMs, and number of foreign personnel – generally limited the growth of foreign banks and foreign investment in the financial sector in the first half of the decade.

[2] To develop Thailand as a regional financial center, the Bank of Thailand introduced the International Banking Facilities in Bangkok [BIBFs] since 1993 and in other provinces [POBFs] since 1994. BIBF permits domestic commercial banks and foreign bank branches to accept deposits in foreign currencies, lend in foreign currencies to both residents and non-residents, and conduct foreign exchange transactions. This led to strong foreign bank lending growth in the first half of the decade.

5. The Asian financial crisis was the watershed year. Restrictions on foreign direct investment in the banking sector were liberalized to various degrees across the ASEAN countries post-crisis, with the exception of Malaysia. Indonesia post-crisis removed all restrictions on the establishment of new banks and the opening of new branches, and relaxed restrictions on foreign participation in existing banks. Thailand lifted foreign shareholding limits on banks from November 1997 for a period of 10 years,[3] which led to a wave of foreign banks acquiring majority stakes in several Thai banks in 1997-99. This includes DBS 50% share in Thai Danu in Dec 97; ABN Amro's 75% share in Bank of Asia in mid-98; Standard Chartered's 75% share in Nakornthorn Bank in Sep 99; and UOB's 75% share in Radanasin Bank in Nov 99.

TABLE 2: Number of Local & Foreign Banks in ASEAN Countries, 1990 –2001

	Singapore		**Malaysia**		**Philippines**		**Thailand**		**Indonesia**	
	Local	Foreign	Local	Foreign	Local	Foreign	Local	Foreign	Local	Foreign
1990	13	124			26	4	15	14	166	28
1991	13	118			27	4	15	14	187	29
1992	13	115			28	4	15	14	203	30
1993	13	119	23	14	28	4	15	14	229	39
1994	12	128	23	14	29	4	15	14	240	40
1995	12	131	23	14	31	14	15	14	240	41
1996	12	140	23	14	33	13	15	14	239	41
1997	12	142	22	14	38	13	14	21	222	44
1998	9	133	22	13	38	12	12	23	222	58
1999	8	132	22	13	38	11	9	25	173	49
2000	8	125	20	14	31	11	9	25	151	39
2001	6	114	13	14	23	18	9	22	145	34

Source: CEIC; Central Bank Annual Reports. Rise in Philippine figures for foreign banks in 2001 due to reclassification of majority foreign-owned domestic banks.

6. The Philippines had already permitted selected banks to open 100% foreign owned branches and allowed foreign investors to acquire up to 60% of local banks before the crisis in 1994. Full liberalization came in May 2000, with full ownership allowed for a 7-year window. Singapore was

[3] After which the shareholding must be reduced to 49%.

relatively less affected by the financial crisis, and embarked on a gradual liberalization scheme for the retail-banking sector in late 1999. This was prompted more by global competitive pressures and rising consumer demands. Technology, such as internet banking, were also neutralizing the advantages of government protection and physical branch networks. Singapore has since granted six qualified foreign full bank licenses with retail banking privileges.[4] Malaysia was the only exception in this regard, maintaining most of the pre-crisis restrictions on foreign participation in the banking sector. Overall, the Asian financial crisis appeared to have catalyzed the liberalization of FDI restrictions in the banking sector across several ASEAN countries.

TABLE 3: Foreign Shareholdings in Thai Commercial Banks, Pre and Post Crisis

	Foreign Ownership (%)	
	As of March 1997	**As of May 2000**
Banks acquired by foreign banks		
Bank of Asia	6	77
DBS Thai Danu Bank	9	62
Standard Chartered Nakornthorn Bank	6	75
UOB Radanasin Bank	…	75
Banks with Thai Majority Ownership		
Bangkok Bank	25	49
Bank of Ayudhya	25	32
Siam Commercial Bank	25	45
Thai Farmers Bank	25	49

Source: Thailand Economic Monitor Feb 00, World Bank; Thai Farmers Research Center, May 2000

7. Post-crisis banking liberalization did not result in an immediate surge in the *number* of foreign banks [see Table 2]. There was generally an across-the-board consolidation for both local and foreign banks, but the level of severity of the consolidation was far greater for the local banks. As a result, the market share of the foreign banks grew because of the relatively sharper fall in the number of local banks; liberalization of foreign investment

[4] The six Qualified Full Banks include Citibank, ABN Amro, HSBC, BNP, Maybank and Standard Chartered.

restrictions; large provisions and write-offs of local banks' assets; and several acquisitions by foreign banks of majority control over existing local banks, particularly in Thailand [see Table 3]. The trend of a rising share of foreign banking assets is therefore similar to Latin America, although the increase was much more modest.

TABLE 4: Market Share of Foreign Banks in ASEAN Countries, 1990 – 2001

% of Total Banking Assets	**Singapore**	**Malaysia**	**Philippines**	**Thailand**	**Indonesia**
1990	50.8	24.2	12.3	4.7	4.4
1991	48.4	23.5	10.7	4.9	4.8
1992	47.0	23.7	9.2	4.9	4.1
1993	45.4	24.4	8.8	6.0	3.7
1994	44.1	22.9	8.2	6.9	3.7
1995	44.2	22.3	10.0	7.7	4.0
1996	45.0	22.4	14.1	8.5	4.1
1997	48.3	21.6	15.8	19.3	7.1
1998	40.5	28.0	17.8	20.1	6.7
1999	42.3	22.6	16.7	18.7	8.2
2000	44.4	24.2	17.3	18.2	8.1
2001	46.3	24.8	18.2	17.6	10.4

Source: CEIC; central bank annual reports.
Notes: Singapore figures based on DBU data; fall in 1998 due to inclusion of POSB after merger with DBS, a local bank.

8. Foreign share of banking assets for Thailand and Indonesia rose sharply after the Asian crisis with the liberalization of the foreign investment restrictions, by about 10 and 5 percentage points, to 17.6% and 10.4% respectively in 2001 [see Table 4]. The foreign banking share for the Philippines also rose in the second half of the 1990s, to 18.2% in 2001 from about 10% in 1995.

9. For Malaysia, there was no substantial change in market share as the FDI restrictions in the banking sector were maintained. Malaysia did not suffer as severely a banking crisis as compared with Thailand and Indonesia. The problem was not systemic and largely concentrated in two banks – Bank Bumiputra and Sime Bank – which accounted for about 22% of the NPLs in

the banking sector. Malaysia as a result did not witness the same pressure to liberalize its FDI restrictions, and post-crisis largely focused on encouraging the local banks to merge to form 10 anchor banks.

TABLE 5: Foreign Bank Presence in the Singapore Banking System, 1990 – 2002

% foreign share	**Total Loans**		**Non-Bank Loans**		**Interbank Loans**	
	DBU	ACU	DBU	ACU	DBU	ACU
1990	53.7	96.3	48.7	99.3	58.8	94.8
1995	46.1	94.6	40.9	95.4	53.3	94.0
2000	43.4	89.2	33.3	87.0	55.9	89.7
Nov 2002	47.3	89.1	36.2	87.6	62.7	89.4

Note: DBU stands for Domestic Banking Unit; ACU stands for Asian Currency Unit. DBU represents largely the "retail" banking activities, while the ACU represents the "offshore" banking activities. The DBU and ACU are therefore treated as separate accounting units of banks.

10. Singapore's banking sector already had a large foreign component to begin with, at close to half of the domestic banking assets. Singapore's retail banking liberalization in 1999 is starting to have an impact on the foreign banks' market share. This is illustrated in Table 5, which provides the foreign penetration rates for both the domestic and offshore banking sector. Foreign bank share of Singapore's retail banking sector has been declining gradually over the decade, but has stabilized and risen slightly in the post-liberalization period. The foreign bank share has risen by about 5 percentage points over the last 2 years. Standard Chartered, Citibank and HSBC are some of the notable foreign banks that have increased their presence.

TABLE 6: Foreign Share of Banking Assets in ASEAN, 1990 & 2001

	1990		2001	
	% Foreign Share	Foreign Bank Assets [US$bn]	% Foreign Share	Foreign Bank Assets [US$bn]
Singapore	50.8	$39.0	44.4	$92.2
Malaysia	24.2	$11.6	24.8	$34.6
Philippines	12.3	$19.3	18.2	$59.7
Thailand	4.7	$3.6	17.6	$25.5
Indonesia	4.4	$3.1	10.4	$10.4
ASEAN	**17.9**	**$76.6**	**24.2**	**$222.4**

Notes: Based on end-of-period exchange rates.
Source: CEIC; Central Bank websites.

11. Table 6 summarizes the ASEAN experience in terms of foreign bank market share and total banking assets in 1990 and 2001. Foreign bank participation, both in absolute and relative share terms, has risen over the last decade. Foreign bank assets have almost tripled over the decade in absolute terms to US$222 billion. The market share of foreign banks have risen to about 24.2% in 2001 from about 17.9% in 1990, driven largely by substantial jumps in the market shares in Thailand and Indonesia.

TABLE 7: Restrictions on FDI in the Financial Sector, ASEAN Countries

MALAYSIA

- Foreign ownership in locally incorporate banks restricted to 30 percent;
- Entry closed to both new local and foreign banks;
- Foreign ownership in insurance companies restricted to 51 percent;
- Foreign ownership in securities companies restricted to 49 percent.

THAILAND

- Foreign ownership in banks up to 100 percent permitted for 10 years, after which foreign-held equity must fall to 49 percent;
- Foreign ownership in direct insurance companies restricted to 25 percent;
- No restriction on foreign ownership in securities companies.

SINGAPORE

- Foreign ownership in locally incorporated banks of up to 5, 12 and 20 percent require MAS approval;
- Restricted number of qualified full bank licenses [6] for foreign banks;
- No foreign ownership restrictions for securities and insurance companies.

PHILIPPINES

- Foreign ownership in banks up to 100 percent permitted for 7-year window from May 2000;
- No restriction on foreign ownership in insurance companies.
- No restrictions on foreign ownership of securities companies; but foreign ownership in securities underwriting limited to 70 percent.

INDONESIA

- Foreigners may directly acquire or purchase bank shares through stock exchange and own up to 99 percent of listed and private banks and joint-ventures;
- Foreigners may establish a new locally incorporated bank w/ local citizens/entities;
- No ownership restriction on securities and insurance companies.

12. Post-crisis, the various degrees of banking liberalization across ASEAN have shifted the relative ranking in terms of financial sector openness [see Table 7]. Malaysia – with a traditionally larger foreign bank

presence – has become the most restrictive, as it still has foreign equity limits on banks, insurance and security companies with entry closed to new foreign banks. Thailand has relaxed its banking sector restrictions, but maintains its foreign equity limit in insurance companies at 25%. Singapore restricts the number of qualified foreign full bank licenses, but has completely liberalized its securities and insurance sectors. The Philippines has more recently permitted 100 percent full ownership for banks, and removed all restrictions on foreign ownership of insurance and security companies.[5] Indonesia has become the most open ASEAN country in terms of foreign direct investment in the financial sector, with no foreign ownership restrictions in the banking, security or insurance sectors. Generally, the foreign ownership restrictions are tightest for the banking sector, and more relaxed for the securities and insurance sectors. Table 12 summarizes the foreign ownership limits for the financial sector.[6]

13. The relaxation of the FDI restrictions has led to mixed outcomes. Thailand has benefited from a surge in FDI into its banking sector, with the foreign acquisition of majority-control over four domestic banks: DBS Thai Danu, Bank of Asia, Standard Chartered Nakornthorn Bank, and UOB Radanassin Bank. Thailand's banking sector attracted US$2.3 billion and US$2.5 billion in FDI in 1998 and 1999 respectively, or about 46% and 77% of total FDI respectively. In the Philippines, liberalization also led to a rise in the number of foreign branches and foreign-controlled domestic banks over the decade, although to a lesser extent than Thailand. Singapore's phased liberalization has also seen greater foreign bank investment and participation in the retail-banking sector over the last few years.

[5] The Philippines also allowed 10 foreign banks to establish branches under the Foreign Bank Liberalization Act in 1994.

[6] There are various other non-equity related restrictions, which may be employed to reduce the extent of foreign participation. These include limits on branches [ML, TH, PH, SP], ATMs [ML, TH, SP], access to local ATM network MP, SP], number of foreign personnel [ML, TH, ID], and nationality requirements for directors [all]. Foreign ownership restrictions also still exist in other financial-related business including asset management companies [ML, TH], financial leasing and factoring services [TH], and reinsurance companies [PH].

TABLE 8: Indonesia, Bank Sales & Privatization Plan			
Under IBRA	**Target Date**	**IBRA's Stake**	**Divestment Stake**
Bank Danamon	Sale of majority stake by end-April 2003	99.4%	A maximum divestment of 71%. The divestment will be conducted in 2 stages; 51% through a strategic sale and a maximum of 20% to be sold via capital market.
Bank Lippo	Offer a majority stake by end-April 2003	60%	Not specified but would be a controlling stake in a bank.
Bank Permata [a merger of 5 banks in Sep 02]	Offer a majority stake by Dec 2003	97.7%	Not announced yet.
Bank Internasional Indonesia	Offer a majority stake in Dec 2003	57%	Not announced yet.
State-Owned Banks	**Target Date**	**Divestment Stake**	
Bank Mandiri	Launch an IPO in June 2003	30%	
Bank Rakyat Indonesia (BRI)	Launch an IPO in Sep 2003	30%	
Bank Negara	No plans yet	No plans yet	

14. Indonesia, in contrast, has experienced much less success, with the recent sale of Bank Central Asia the only notable achievement to date.[7] The "Bank Bali Scandal" in July 1999 is an example of the risks, when auditors revealed that US$80 million was missing from the books, which led to Standard Chartered's retreat from a deal to acquire a 20 percent stake. The Indonesia Bank Restructuring Agency will be trying to sell stakes in several major state-owned banks over the next 2 years, including Bank Danamon and Bank Lippo. Bank Indonesia is also in the process of privatizing Bank Mandiri and Bank Rakyat Indonesia [see Table 8].

15. The experience of ASEAN suggests that there is no direct correspondence between the degrees of banking liberalization with the severity of contraction during the Asian crisis. Thailand and Indonesia had relatively closed banking systems, with foreign bank market share of less

[7] Farindo Investment, a joint-venture between Farallon Capital Management of the US and Alaerka Investment, a company controlled by cigarette company PT Djarum, won the government tender for the 51% stake in BCA over favorite Standard Chartered.

than 10 percent before the crisis. But both countries were hit the hardest during the crisis. Singapore had a relatively open banking system with foreign banks owning almost half of retail banking assets, but emerged relatively unscathed from the crisis. The severity of the financial crisis had more to do with the capital account liberalization and weak domestic banking systems, than banking sector liberalization or foreign bank presence per se.

16. There is moreover some evidence, although not conclusive, to suggest that foreign bank presence may have helped to stabilize the banking system. In Thailand, foreign bank assets increased sharply in the second half of 1997 as domestic banks faced a credit crunch from the withdrawal of interbank credit. The equity or balance due to head office and net borrowing position from the interbank market for foreign bank branches in contrast rose strongly to meet the higher loan demand. In Singapore, the amount due to head offices for foreign bank branches also rose sharply by about 35 percent in 1997.

TABLE 9: Thai Commercial Banks: NPL Ratios, Deposits and Loans, 1997 – 2002

	NPL Ratio (%)					Deposits (% Share)		Loans (% Share)	
	Private Commercial Banks	State-owned Banks	Total	Foreign Bank Branches	Total	Thai Banks	Foreign Branches	Thai Banks	Foreign Branches
Dec97	19.4	29.3	22.6	1.9	18.7	94.4	5.6	81.0	19.0
Dec98	40.5	62.5	48.2	9.8	42.9	95.7	4.3	85.4	14.6
Dec99	30.6	62.9	42.5	9.9	38.6	94.7	5.3	87.1	12.9
Dec00	18.0	21.6	19.3	6.6	17.7	94.6	5.4	87.6	12.4
Dec01	14.4	5.6	11.5	3.2	10.5	94.2	5.8	88.1	11.9
Nov02	10.9	5.3	13.7	3.6	10.1	94.0	6.0	88.9	12.4

Source: CEIC

17. Foreign banks also have significantly lower non-performing loans than local banks, providing an important buffer and raising the stability of the banking system as a whole. In Thailand, the NPL ratios for the foreign bank branches in Dec 98 was about 9.8%, considerably lower than the NPL

ratio of 40.5% for the private commercial banks or the 62.5% for the state-owned banks [see Table 9].

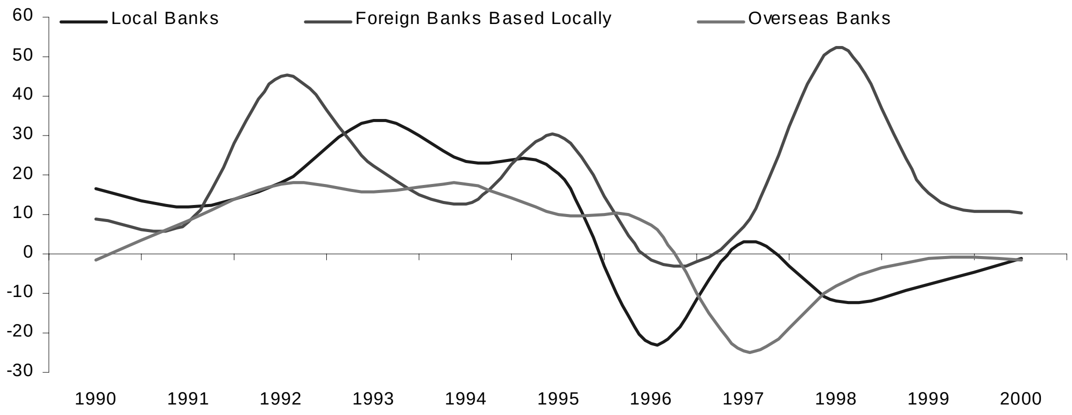
18. Another important trend in the post-crisis period is the growth in lending from locally based foreign banks. Annual growth in bank lending for foreign banks based locally in recent years have exceeded those of local banks and overseas banks [see Chart 1]. In Malaysia and Thailand, local claims by BIS reporting banks have already exceeded international claims [see Charts 4 & 5]. This is in contrast to the pre-crisis period where cross-border lending demonstrated the highest growth rates but fell sharply after the crisis [see Chart 2]. Liberalization post-crisis has led to a rise in locally based foreign bank lending in ASEAN countries, substituting to some degree the fall in cross-border lending [see Table 10]. Capital controls, imposed to varying degrees in Malaysia, Thailand and Indonesia, may have also discouraged the growth of cross-border lending. This shift is generally favorable, as locally based foreign bank lending is largely denominated in local currency and less volatile than cross-border lending.

TABLE 10: Bank Lending in Southeast Asia (US$ billion)

	1990	**1996**	**2001**
Local Banks	178	547	350
Locally Based Foreign Banks	16	47	97
Overseas Banks	211	398	287
TOTAL	**405**	**993**	**735**

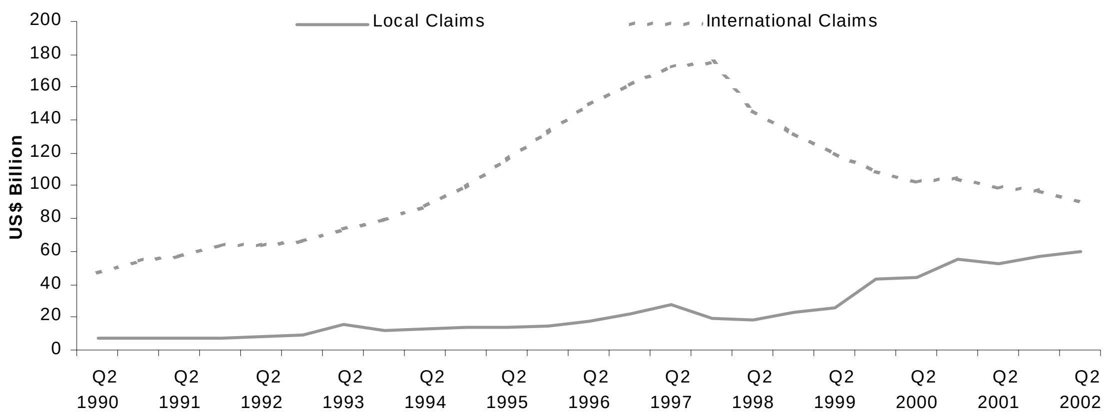
Source: BIS, CEIC. BIS Line 9L proxy for locally based foreign banks, 9C for overseas banks.

CHART 1: Annual Growth in Bank Lending to Southeast Asia



Source: BIS and CEIC. ASEAN includes Singapore, Malaysia, Philippines, Indonesia and Thailand. BIS Line 7L as proxy for foreign banks based locally; Line 7C for overseas banks.

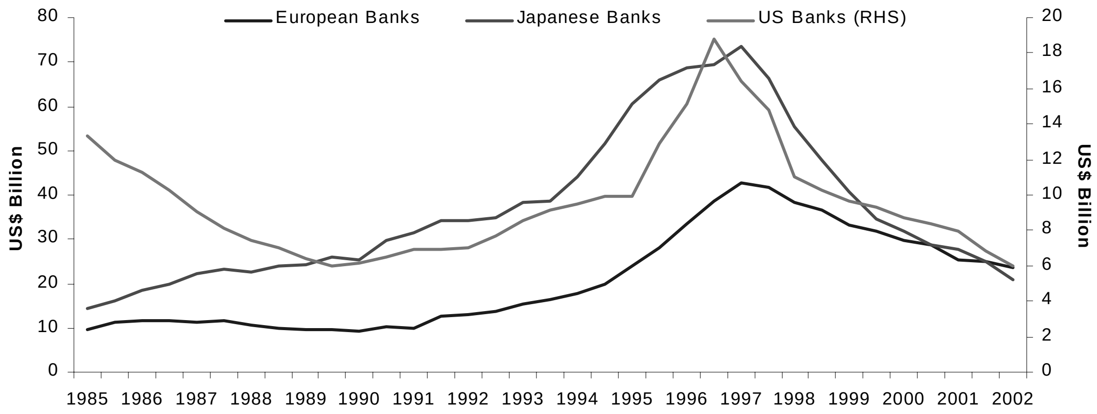
CHART 2: International Claims & Local Claims of BIS Reporting Banks, ASEAN-4 Countries, 1990 - 2002



Source: BIS. International claims line 9A; local claims line 9L.

Notes: Local claims include local currency claims only. ASEAN-4 consists of Malaysia, Thailand, Indonesia and Philippines. Singapore excluded due to offshore market activities. Inclusion would not affect observed trends.

CHART 3: Consolidated Foreign Claims of Banks on ASEAN-4, 1985-2002



Source: BIS; ASEAN-4 excludes Singapore.

CHART 4: Malaysia: International & Local Claims of BIS Reporting Banks

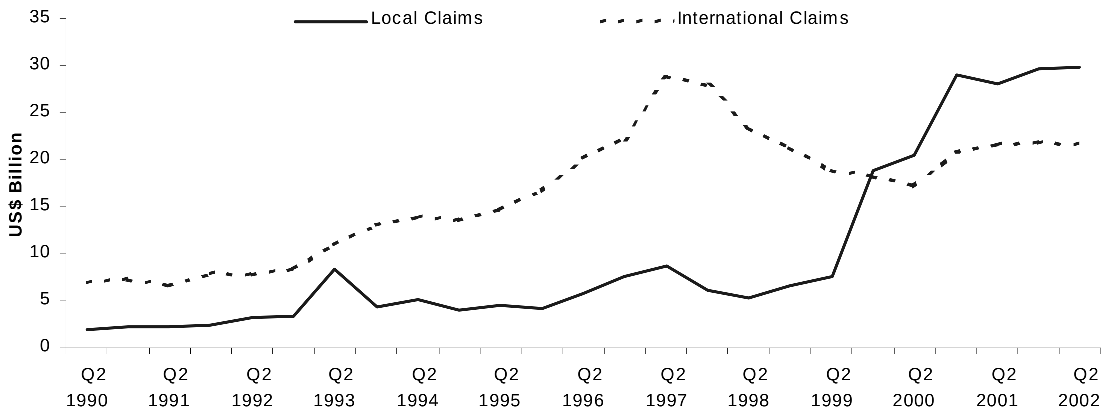


CHART 5: Thailand: International & Local Claims of BIS Reporting Banks

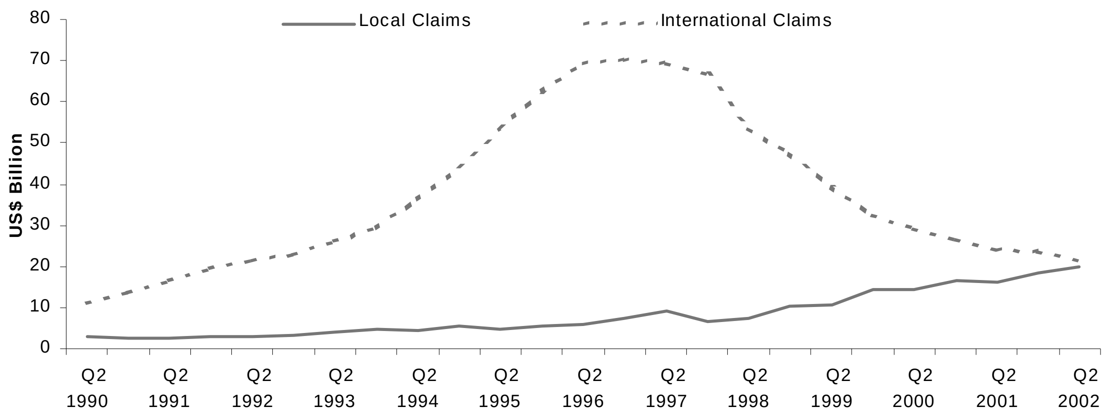


CHART 6: Singapore: International & Local Claims of BIS Reporting Banks

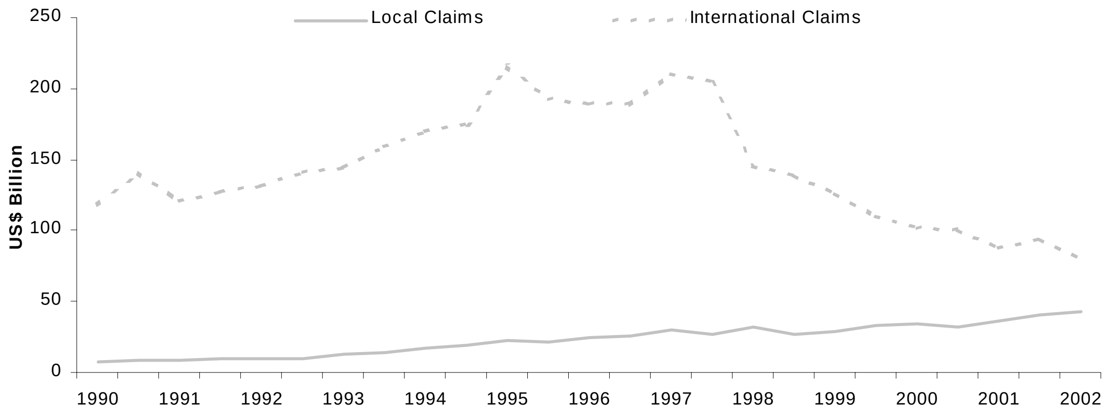


CHART 7: Indonesia: International & Local Claims of BIS Reporting Banks

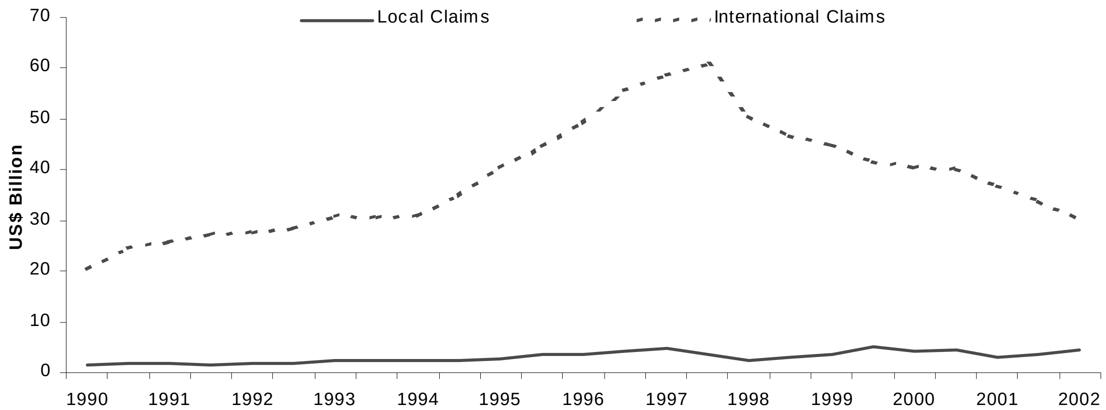
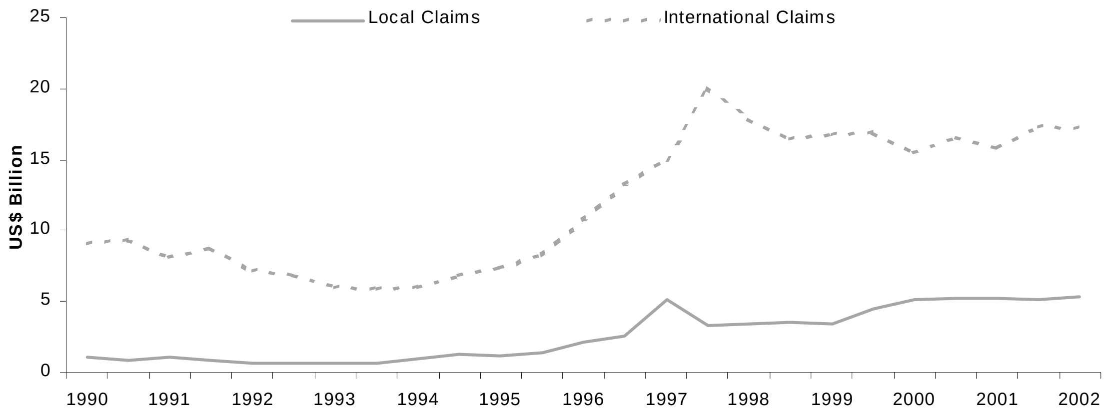


CHART 8: Philippines: International & Local Claims of BIS Reporting Banks



19. Another important trend is the increasing participation of non-Japan Asian banks in Southeast Asia. Japanese banks are the traditional Asian source of lending to and investment in East Asia's financial sector. More recently, non-Japan Asian banks have been gradually acquiring stakes and expanding their presence in regional banks. This includes for example Singapore banks DBS and UOB acquiring majority stakes in Thai Danu and Radanashin Bank in Thailand; Maybank's rising participation in Singapore after being awarded a Qualified Full Bank license; the interest from Taiwan and Hong Kong banks in several Philippines bank;[8] the expansion of Singapore and Hong Kong banks in China[9]; and the considerable interest from non-Japan Asian banks in Indonesia's bank divestment and privatization. The pool of FDI source countries from Asia is therefore growing and diversifying.

20. The entry of foreign banks has also been a catalyst for change amongst the local banks, in particular forcing local banks to cut costs, raise efficiency levels and adopt new technology. Local bank consolidation was clearly seen across the ASEAN countries. In Thailand, several large local banks moved to cut excess staff by launching early retirement schemes, including Thai Farmers Bank [target 2,000 employees] and Bangkok Metropolitan Bank [target 1,000 employees]. Employment in the banking sector has generally fallen by about 13% to about 94,202 persons in March 2000 from 109,526 persons in 1998.[10] Thai Farmers Bank and the Siam Commercial Bank launched e-banking services in the first half of 2000.

[8] HSBC purchased a 100% stake in PCI Savings bank, a thrift unit of the Philippines second largest lender Equitable PCI Bank. First Commercial Bank, a Taiwan state-owned bank, has expressed interest in purchasing a 60% stake in a Philippines bank. Taiwan-based Hua Nan Commercial bank has also expressed interest in acquiring an Indonesian bank.

[9] Notably Hong Kong's Hang Seng Bank and Singapore's UOB Bank.

[10] Some estimates suggest that western banks on average staffed their branches with 10 or fewer employees while the number for Thai banks was closer to 30 employees.

21. In Singapore, the liberalization of retail-banking sector has led to two large local bank mergers: UOB and OUB, and OCBC and Keppel Tat Lee Bank. Significant staff cuts were made with the mergers since the third quarter of 2001. Post-merger, the three large local banks collectively have consolidated and cut the number of branches by about 40 percent.

22. Another benefit from foreign bank presence is the improvement in the corporate governance structure of the domestic banks. This includes breaking down the family-controlled structure and improving the decision-making process for loans. Other advantages of foreign majority ownership include the availability of funds for capital, infusion of advance technology, introduction of new banking products, and acquisition of consumer-marketing skills.

23. Resistance or costs to foreign ownership however does exist. Concerns over job security and retrenchments at foreign banks weaken the political support for liberalization. There are natural concerns that local banks are unable to compete against the established foreign players, and as a result, reduce the profitability and pressure the capital base of the systematically important local banks.[11] Considerable concerns over foreign presence in the banking sector nevertheless remain, as seen by having restricted time-window for FDI [Philippines 7 years; Thailand 10 years]; the highly politicized events whenever a foreign party bids for a majority interest in a local banks; and the demonstrations by bank employees because of fears of job cuts [Radanasin Thailand; BCA Indonesia].

24. Banking liberalization and greater foreign bank participation has pushed ASEAN central banks to assess issues over the “level playing field”

[11] Claessens et al. (1998) for example shows that a larger foreign-ownership share reduces the profitability and the overall expenses of domestically owned banks, using a sample of bank level data for 80 countries in the 1988-1995 period.

between local and foreign banks. Issues such as deposit insurance and basic banking services were less stark with a local bank dominated system. Central banks will now have to provide greater certainty and clarity on the extent of deposit insurance coverage for and fund contributions from foreign banks. Several ASEAN countries, including Singapore, are considering a deposit insurance scheme.

25. Local banks also often had to satisfy "national duties" by servicing rural or poorer segments of the population, which impaired their profitability. Central banks will now have to define what social or public responsibilities at a minimum, such as basic banking services, foreign and local banks should provide. Central banks are also largely focusing in improving the corporate governance standards of local banks, which may turn out to be more demanding and costly, than the parent or source-country standards for foreign banks, possibly putting the local bank at a disadvantage. Many of these level-playing field issues are surfacing with greater foreign participation, and ASEAN countries are only starting to grapple with many of the policy issues.

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