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The Effect of Asean Financial Services Liberalisation on Economic Growth

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Abstract

In 1997, ASEAN agreed to liberalise the trade in financial services in the region marking its initial agreement with AFAS (ASEAN Framework Agreement in Services). In 2019, AFAS concluded the eighth round of the trade in financial services negotiations. Based on the agreement, this research aims to quantify the level of openness and investigate the connection between the openness level and and the economic growth ASEAN 5 countries. Using random effects panel data, the ASEAN financial services liberalisation positively and significantly affects economic growth. The results confirm that liberalisation is on track. Learning from the European Union's experience in financial services integration, this research suggests that strengthening cross-border regulation and supervision is essential for moving forward after liberalisation.

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INTRODUCTION

Services trade has been regarded as a cutting-edge potential growth engine (Sermcheep, 2019). From 2010 to 2019, the ASEAN services trade volume increased. However, in 2020 and 2021, there was a sharp decrease due to the COVID-19 pandemic, but it bounced back in 2022. Services businesses were halted in 2020 and 2021 as the COVID-19 pandemic limited business activity, but they bounced back in 2022 as countries relaxed restrictions.

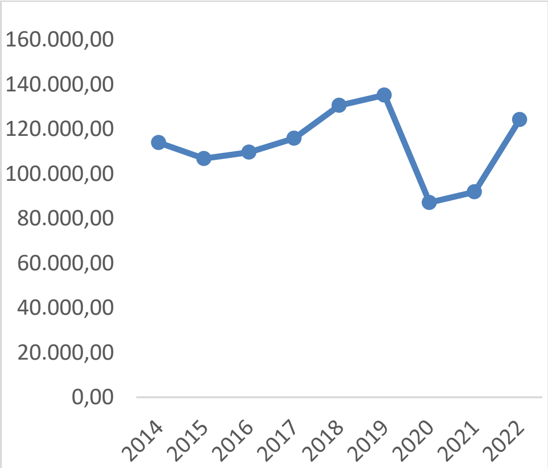

Figure 1. ASEAN Trade in Services (million USD)
Source: ASEANStats, 2023 (Processed)

The services sector has recently been regarded as an essential aspect of the ASEAN region. In 1997, ASEAN trade and economic ministers agreed on the first negotiation package of AFAS (ASEAN Framework Agreement on Services), enabling ASEAN member states to liberalise trade in services. ASEAN services trade liberalisation encourages competitive market environment to enhance services business (ASEAN, 2013).

Under AFAS, financial services are among the sectors mandated for liberalisation. Financial services liberalisation is anticipated to facilitate market access across regions, inviting more market players and, consequently, enhancing efficiency and competitiveness (Rillo, 2018). The initial financial services trade agreement package was signed in 1997, and by 2021, eight negotiation packages were signed. With each successive package, the agreement tends to become more liberal.

In the ASEAN 5, the level of openness in the service sector also varies among countries. Data from the Service Trade Restrictiveness Index (Figures 2 and 3) showed that Singapore and Malaysia have higher levels of openness compared to Indonesia and Thailand. AFAS has recognized these disparities in service barriers and has made efforts to bridge such differences.

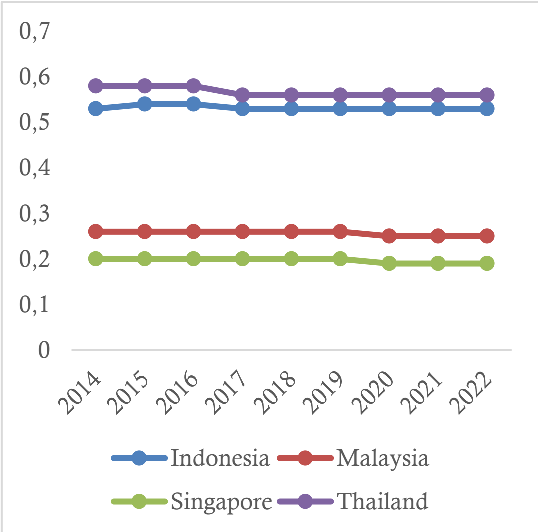

Figure 2. Insurance Service Restrictiveness
Source: Services Trade Restrictiveness Index, 2023 (Processed)

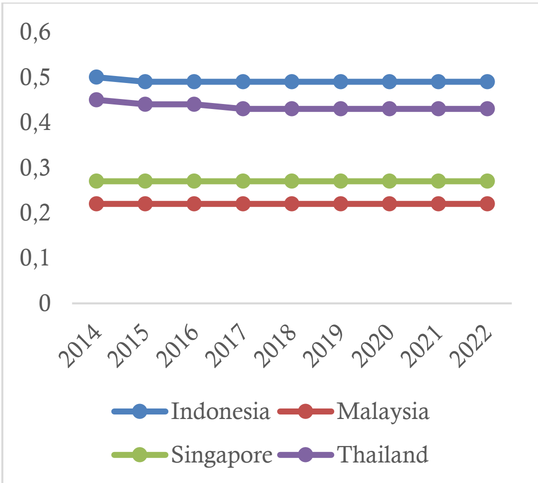

Figure 3. Banking Service Restrictiveness
Source: Services Trade Restrictiveness Index, 2023 (Processed)

The willingness of ASEAN countries to engage in AFAS negotiations underscores the importance of liberalising ASEAN trade in financial services, which is expected to benefit the economy. In theory, services liberalisation can leasa to economic growth and increased efficiency (Hapsari & MacLaren, 2012).

Furthermore, economic growth can be facilitated through services trade liberalisation, which will stimulate competition among foreign and domestic firms. (Mattoo, Rathindran & Subramanian, 2006). Liberalisation in financial services is expected to enhance domestic competitiveness, reducing regulatory capture and minimizing ideological constraints regarding free financial markets (Park & Takagi, 2012). Critics of the development of financial services liberalisation are highlighted by Dee (2015) and Park & Takagi (2012) as they assess the progress of service liberalisation development in ASEAN.

Dee (2015) argues that in banking services, the commitment from ASEAN Member States (AMS) lags behind actual practices, suggesting that the actual practice is less liberal than the commitment. Dee (2015) states that countries often impose prudential measures to protect their financial stability. This assertion aligns with Park & Takagi (2012), who argue that ASEAN imposes strict regulations on foreign banks entering the country and their operations.

In 2014, AFAS recognised ABIF as part of its framework to accelerate banking liberalisation in ASEAN (Wijaya et al., 2019). Driven by Indonesia and Malaysia, ABIF has undoubtedly undoubtedly influenced the AFAS negotiation. One notable clause introduction by AFIF is the Qualified ASEAN Bank (QAB), wherein an ASEAN bank meeting certain qualifications is treated as a domestic bank in another country (Remolona et al., 2015). The ABIF clause is negotiated in two stages: the multilateral stage, where countries negotiate the clause simultaneously, and the bilateral stage, where at least two countries can further negotiate bilaterally on a more advanced level (Ibid). The agreement progresses at two speeds, with ASEAN5 (Indonesia, Malaysia, Thailand, Singapore, and The Philippines) leading the way, followed by the BCLMV (Vietnam, Lao PDR, Myanmar, Brunei Darussalam, and Cambodia) will follow.

Hapsari and MacLaren (2012) found a positive connection between ASEAN financial services liberalisation and economics using data from 1997 to 2008. However, given the current development of ASEAN financial liberalisation and the introduction of ABIF, it is essential to re-examine the impact of the liberalisation on the economy. Similar to them, the focus on ASEAN5 countries is more critical because ASEAN adopting a double-track approach for ASEAN5 vs BCLMV, where the ASEAN5 is allowed to enter more advanced negotiation due to its better financial sector depths (Wihardja, 2013). The development from the ASEAN5 countries can be a future lesson for the BCLMV when they are ready.

Economic cooperation among ASEAN countries began with the Bangkok Declaration in 1967. This cooperation aims to accelerate economic growth and promote social and cultural development. In 1995, ASEAN Member States signed the ASEAN Framework Agreement on Services (AFAS), which mandates progressive negotiations for liberalising service trade. Through progressive liberalisation in ASEAN, local service providers will have the opportunity to capitalize on market openings and benefit from new ideas and processes resulting from the expansion of the services sector. A well-managed and progressive liberalisation of services by ASEAN will enhance productive capacity and foster economic development (ASEAN, 2007).

Financial services are one of the sectors covered under AFAS and are negotiated separately from the main body due to their unique requirements. From 1997 to 2021, ASEAN Finance Ministers signed eight negotiation packages. The initial package was signed in 1997, followed by the second in 2002. Notable progress in the second commitment package include the opening of Indonesia's banking sector, which committed to allowing up to 51% foreign equity, a significant shift from its initial "unbound" stance. Similarly, the Philippines increased its banking and insurance commitments by allowing 60% foreign equity, up from 49%. Subsequent negotiations were accelerated following the implementation of the Roadmap for ASEAN Integration in Finance (RIA-Fin), aimed a further deepening ASEAN's financial and monetary integration by 2015. The third and fourth negotiations concluded in 2005 and 2008, respectively, with notable progress from Singapore, which eased its "none" commitment to "unbound" in mode 3 of the banking sector, while and Malaysia shifted from "none" to mode 2 in its banking sector. The fifth and sixth packages were signed in 2011 and 2015, respectively, with Malaysia further easing its commitment in mode 3 of insurance from "unbound" to "allowing with a state license" enabling businesses to established with the requirement of a ministry license.

After 2015, ASEAN reinstated progressive liberalisation as a means to achieve financial integration, with the goal outlined in ASEAN's 2015 plan (ASEAN, 2015). ASEAN aimed to conclude a package negotiation approximately every two years, resulting in the conclusion of the seventh and eighth packages of negotiations in 2016 and 2019, respectively. This phase introduced new features as ASEAN adopted the ASEAN Banking Integration Approach (ABIF). According to Wihardja (2015), an integrated banking system in the region would promote more cross-border lending activities, expand domestic credit, and offer additional options for financing fiscal needs. Furthermote, an integrated banking system could attract foreign investors to acquire domestic bonds, increasing capital influx. A notable difference is the ASEAN 2+X scheme, allowing two ASEAN countries to negotiate more liberal terms between themselves and gradually expand to other countries. However, this only applied to the negotiation of mode 3 in the banking sector.

Understanding the impact of the ASEAN financial services liberalisation is essential for evaluating the effectiveness of the agreement, which has been in place for more than 20 years. While similar research was conducted by Hapsari & MacLaren (2012) in 2007, it has yet to capture the dynamism observed after 2007, including the accelerated negotiation process and the introduction of ABIF.

Existing literature demonstrates a positive correlation between financial openness and economic growth. According to Todaro & Smith (2015), traditional neoclassical theory posits that countries with low savings tend to adopt closed economics, leading to lower income convergence. Conversely, countries with open economies experience increasing income convergence due to capital flows from higher savings countries to lower savings countries.

Tamirisa (2003) explains how opening financial services can affect the economy. Capital flow liberalisation and the liberalization financial services have the potential to impact capital and investment. In a borderless environment, a country with high-savings will transfer its surplus to a country with low savings. In other words, capital flow will promptly allocate savings and investment across countries. Tamirisa (2003) argues that investment levels will increase when capital can flow freely and financial services are traded without restrictions between countries. Free capital flow and liberalized financial services will facilitate the movement of savings into productive sectors and increase competition and technology transfer among financial institutions.

Research by Hermes & Lensink (2006) on financial sector liberalisation in the 1970s indicates that many countries imposed financial oppression or strict controls on financial activities. These measures included implementing lending rate limits, controlling credit, and limiting or closing access to foreign financial institutions to operate domestically. According to Mckinnon (1973, as cited in Hermes & Lensink, (2006) and Shaw (1973, as cited in Hermes & Lensink, (2006), such actions can hinder economic growth. tThe financial sector should be granted sovereignty and freedom to operate according to market conditions. This would enhance efficiency and encourage capital to flow into productive sectors.

The importance of an efficient financial sector is emphasised by Levine (1997). The financial sector plays a crucial role in stimulating economic growth by fostering the development of other sectors through capital accumulation and technological innovation. Moreover, it mobilises savings and provides high-quality, low-risk financial instruments, thereby boosting investment and overall economic growth. A more efficient financial services sector can also reduce asymmetric information, thereby decreasing transaction costs and information costs (Levine, 1997).

Existing literature suggests a positive correllation between financial services liberalisation and economic growth. Mattoo et al. (2006) investigated the impact of services trade liberalisation on economic growth. The paper addresses the challenges associated with quantifying services trade liberalization, particularly due to the non-tariff nature of many barriers in the services sector. It outlines a methodology for measuring liberalisation, assessing regulatory restrictions, market access, and policy changes. They conduct a method to determine a country's level of trade in services liberalisation by combining its commitment to GATS (General Agreement on Trade in Services), a capital control index from Dailami, and foreign ownership allowance from a country. Using data from sixty countries from 1990 to 1999, they conduct regressions and find that countries opening their financial and telecommunication services experienced growth rates 1.5% faster. However, the research acknowledges limitation such as data constraints and the challenge of fully capturing the effects of services trade liberalisation.

Hapsari & MacLaren (2012) examined services liberalisation within ASEAN. Hapsari & MacLaren (2012) used the same variable and index construction method by Mattoo et al. (2006). However, the scope of the country is limited to 5 ASEAN countries in the period from 1997 – 2008, and the index is based on AFAS commitment instead of GATS commitment. The ASEAN committed that AFAS is a GATS-plus commitment.

Hapsari & MacLaren (2012) employed distributed lag analysis to explore the short-run and long-run impacts of liberalization. From this research, financial services liberalisation does not affect lag 0 but significantly affects lag 1. This research is significant for evaluating the AFAS commitment, as it highlights the challenges in distinguishing whether the observed impact stems from the AFAS commitment itself or from GATS.

Wang et al. (2008) investigated the effects of financial liberalisation under WTO to the economy. Similar to Mattoo et al. (2006), the study begins by addressing the challenges associated with quantifying services trade liberalisation, given the non-tariff nature of many barriers in the services sector. However, Wang, Shen & Liang (2008) constructed the liberalisation index solely based on the GATS commitment, with a more profound scoring method than Mattoo, Rathindran & Subramanian (2006). The liberalisation index developed by Wang et al. (2008) was based on Mattoo (1998) but with modifications to include mode four transactions in the index construction. In their model, they indulge different scenarios about the sector being liberalised. When considering only banking liberalisation index, the result indicate that liberalisation does not significantly impact GDP per capita growth. However, when all sectors are involved, the results show a non-significant in lag 0 but positive significant in lag 1. Additionaly, the study suggests that liberalissation indirectly affects bank concentration as a variable.

The research aims to analyses the level of openness of ASEAN Financial Services under the AFAS agreement and investigates its economic impact. This research holds significance due to the longevity of the agreement since 1997 and has gone through 8 rounds of negotiations. The introduction of ABIF in 2015 has been a pivotal development, enabling more aggressive liberalisation in the banking sector. Therefore, the result of this research will provide valuable insights for policymakers in ASEAN and inform future decisions. Based on the previous theory and research, the hypothesis made in this research is that the ASEAN financial services liberalisation positively impacts ASEAN5 GDP growth.

RESEARCH METHODS

This research constructs an ASEAN financial services liberalisation index based on guidance from Mattoo (1998), using it as as a proxy of financial services openness. Mattoo (1998) constructed a liberalisation index based on GATS. As AFAS is based on GATS, we can use the same guidance to construct a liberalisation index on AFAS.

The liberalisation index is constructed by scoring on the country's commitment to AFAS under the Schedule of Commitment (SoC). In SoC, there are sectors, sub-sectors, and transaction modes. According to Mattoo (1998), insurance and banking are the sectors to be included in measurements. Only two subsectors are included in the measurement: life and non-life insurance from the insurance sector and savings and deposits from the banking sector. The four subsectors are considered core business in financial services (Mattoo, 1998). Each subsector has four modes of transaction. However, only modes 1, 2 and 3 are included in the measurement, as mode 4 is considered insignificant.

Table 1. Mode 1 and 2 Scoring Method

Commitment	Score
Unbound	0
None	1
Partial	0.5

Source: Mattoo (1998)

Table 2. Mode 3 Scoring Method

Commitment	Score
No New Entry or unbound for a new entry	0,1
Discretionary licensing for new entry	0,25
Ceiling on foreign equity at less than 50%	0,5
Ceiling on foreign equity at more than 50%	0,75
Restriction on the legal form of commercial presence	0,75
Other minor restriction	0,75

Source: Mattoo (1998)

After choosing which sectors, subsectors, and modes to include in the measurement, the next step is to assign scores in each mode of transaction and determine the weight of each subsector and sector. For the mode of transactions 1 and 2, 0 points will be given for "unbound" commitment, 0.5 for "partial" commitment, and 1 for "none" commitment. Mode 3 has a special arrangement because it is considered significant, requiring more advanced scoring.

After determining the scores for all transaction modes, the next step is to assign weights to each mode and subsector. According to Mattoo (1998), the weights are presented in Table 3. Mattoo (1998) based his weights on the US trade data, as the US is the only country that provides trade information on each mode of transaction.

Table 3: Mode 1, 2, 3, Scoring Weight.

		Mode 1	Mode 2	Mode 3
Banking	Deposit	0,12	0,03	0,85
	Lending	0,2	0,05	0,75
Insurance	Life	0,12	0,03	0,85
	Non-Life	0,2	0,05	0,75

Source: Matoo (1988)

Note: in each sector, the liberalisation index, L, for each country j, is defined as

$L_j = W_i R_i^j$; i = Mode 1, 2, 3

Where W_i is the modal weight and R_i is the numerical value of the most restrictive measure applied by country j to mode i. The liberalisation index is thus the modal weighted average of the value of the most restrictive measure applied by a country to each mode in the sector.

This research constructed a model based on Mattoo, Rathindran & Subramanian (2006). The dependent variable in this research is Gross

Domestic Product (GDP) per capita growth, following the approach of Mattoo et al. (2006) and Hapsari & MacLaren (2012). The main independent variable is the ASEAN5 liberalisation index, constructed following the guidance provide by Mattoo (1998). Furthermore, population growth, gross capital formation and inflation are also included as control variables. The inclusion of the control variables is based on the research by Hapsari & MacLaren (2012) and Wang et al. (2008). According to previous research, the liberalisation index, population growth, and gross capital formation positively relate to GDP growth. At the same time, inflation is expected to affect growth negatively.

Thus, the model is constructed in Equation 1:

$$GDPGit = \beta0 + \beta1GCFit + \beta2POPGROWTHit + \beta3INFit + \beta4LIBINDEXit + \epsilon it \quad ....(1)$$

Where GDPG is the GDP growth of country I in year t, GCF is the Gross Capital Formation of country i in year t. POPGROWTH is the population growth of country i in year t. INF is the inflation rate of country i in year t. LIBINDEX is the liberalisation index constructed using Matto's (1998) guidelines for country i in year t. Lastly, $\beta0$ and ϵit are constants and error terms, respectively.

Panel data regression will be utilized to examine the impact of the independent variables on the dependent variable, covering five countries (Indonesia, Malaysia, Singapore, Thailand, and The Philippines) from 1997, which marks the first package of the ASEAN financial services liberalisation agreement, to 2020. The Hausman test will determine whether the most suitable model is random effects or fixed effects panel regression.

RESULTS AND DISCUSSION

From 1997 to 2020, 8 rounds of negotiation were agreed by ASEAN countries. In the initial round of 1997, all ASEAN countries made the same commitment as their GATS commitment. During this time, ASEAN countries have committed notable changes.

Singapore and Thailand had the lowest scores initially, as they imposed highly restrictive measures in mode three of the banking sector. Singapore put “no new license for the new establishment”, and Thailand put “new license is subject to the approval of the ministry of finance and cabinet”. In the second package, Singapore changed the insurance sector by allowing up to 49% foreign equity. Lastly, in the 8th package, Singapore substantially increased by joining the ABIF commitment with Indonesia and Malaysia.

Thailand’s initial score was kept until 5th package of negotiation, with the change made in the banking sector by committing to allow a maximum foreign equity of up to 25%. In the 7th and 8th package, Thailand’s score increased as they committed to joining the ABIF and allowed QAB to operate domestically. Malaysia’s story was similar as the initial score was low but gradually increased, and then in the 6th – 8th package, the score increased as the ABIF was kicked in. The introduction of ABIF also increased Malaysia’s score by allowing QABs to be treated as local banks.

Indonesia’s score was relatively high in the region as they allowed foreign equity up to 100% in the insurance sector in the initial negotiation package while putting “unbound for new license” in the banking sector, meaning no commitment for giving new license for a foreign entity to enter the business. However, in the second round, Indonesia opened its banking sector and allowed new banks with up to 51% foreign equity. The introduction of ABIF did not change Indonesia’s score as it had already opened its sectors in the first place. The Philippines’ commitment was open since the first package and has not changed. Since the initial package, The Philippines has allowed up to 60% of foreign equity in both the insurance and banking sectors. Table 4 shows the constructed index based on the country’s commitments.

Table 4. Liberization Index

Package	Year	Indonesia	Malaysia	Singapore	Philippines	Thailand
1	1997	0.4	0.3	0.14	0.6	0.08
2	2002	0.6	0.3	0.24	0.6	0.08
3	2005	0.6	0.3	0.24	0.6	0.08
4	2008	0.6	0.3	0.24	0.6	0.08
5	2011	0.6	0.3	0.24	0.6	0.24
6	2015	0.6	0.4	0.293125	0.6	0.24
7	2016	0.6	0.4	0.293125	0.6	0.3
8	2019	0.6	0.4	0.34	0.6	0.4

Source: Data Processed, 2023

Table 5. Regression Result

Growth	1st Regression	2nd Regression	3rd Regression
Libindex	1.278865	2.952076**	3.3721030***
Popgrowth	0.450395***	0.5461873***	0.5391221***
INF		-0.2453459***	-0.2525222***
GCF			0.1189557***
r^2 overall	0.0145	0.1468	0.1702

Source: Data Processed, 2023

According to the Hausman test, random effect is the most suitable model for the model. The random effects model assumes that the unobserved entity-specific heterogeneity is random and incorporates its effect into the model by exploiting its distribution (Das, 2019).The regression is conducted individually using the control variables to ensure robustness and structural consistency (Lu & White, 2014). The regression result can be seen in Table 5. In the first regression, only the financial openness variable and population growth were included, and the result is that population growth showed a significant and positive impact. However, it was not significant for financial openness.

In the second regression, inflation is included along with the variable in the first regression. In this model, the financial openness and population growth significantly and positively impacted GDP growth, while the inflation showed a negative and significant impact. In the last regression, GCF is included in the equation, and the result showed that financial openness, population growth, and GCF have a positive and significant impact on GDP growth. In contrast, inflation has a negative and significant impact.

From the three regressions above, it is concluded in the third regression that the consistency is met, proving that the model is robust. The main finding from the regressions above is that the financial services liberalisation index positively and significantly impacts the ASEAN5 GDP growth at 1% confidence.

The above results implied that an increase of 1 point of liberalisation index increases the GDP growth by 3%, or an increase of 0.1 point of liberalisation will increase GDP growth by 0.3%. The positive impact of ASEAN financial liberalisation amplified Hapsari & MacLaren (2012) previous works. However, in the previous work, the positive impact was prevalent in the next two years (lagged two years). The other results showed a positive and significant impact of population growth and gross capital formation on GDP growth and a negative and significant impact from inflation on GDP growth.

The impact of financial liberalisation in ASEAN is prevalent. According to Hapsari & MacLaren (2012), as the ASEAN member countries become more integrated and open their services sector to other member countries, it will be beneficial as the service cost will be reduced, and efficiency will be increased. When a country benefits from liberalisation, then the government will benefits from liberalisation, then the government will encourage reform of its policies. This reform includes changes in AFAS GATS or both.

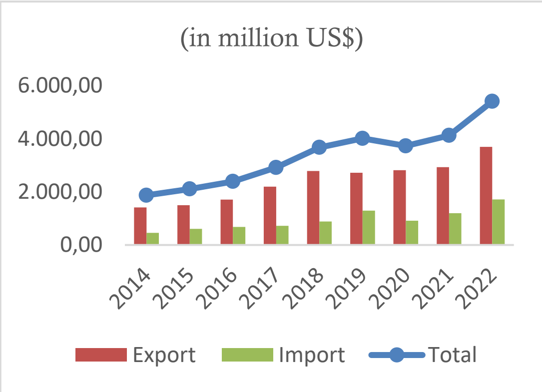

Figure 4: ASEAN Trade in Financial Services
Source: ASEANStats, 2023 (Processed)

From Figure 4, the number of trade in financial services intra-ASEAN is increasing, though a little bit hampered in 2020 and 2021 due to the pandemic covid – 19 situation, but in 2022, it bounced back positive again. The AFAS's purpose is to promote a more accessible flow of goods and services, and the underlying figure above shows a positive sign that AFAS, especially in trade in financial services.

With AFAS, ASEAN has successfully reduced their restrictiveness. According to CIMB (2015), AFAS has successfully increased the agreement's subsectors and the minimum equity participation (the ownership allowance for a foreign entity). AFAS commitments have unquestionably created greater regional policy certainty (ASEAN, 2015). Under AFAS, ASEAN has further liberalised the financial sector compared to the GATS commitment. As seen in Table 6, from the fifth package of negotiation, ASEAN countries have committed 276 sub-sectors in financial services, a 70% increase from the previous package. These commitments are primarily in banking, insurance, and capital market sub-sectors. Thus, a progressive commitment has been made across the subsectors over the years (Rillo, 2018).

According to Rillo (2018), as seen in Table 7, in the fifth package, the overall liberalisation rate is 59%, or a 5% increase compared to the second package and a 6% increase compared to the initial package or GATS agreement. This concludes that ASEAN countries have submitted higher commitment levels than the GATS commitment to substantially eliminate barriers to trade in financial services, paving the way for further integration of financial markets.

As banking and insurance still dominate financial services, work to intensify liberalisation in the two sectors is underway. ABIF was introduced in 2014 and established ASEAN QAB, a breakthrough. In the insurance sector, ASEAN has finalised the ASEAN Insurance Integration Framework to undertake a more progressive liberalisation, encourage a competitive market for the insurance industry, and provide more choices for consumers (Rillo, 2018). This framework allows ASEAN countries to liberalise the cross-border supply of Marine, Aviation, and Goods in International Transit (MAT) insurance, providing meaningful support for investment, trade, and economic integration under AEC (Rillo, 2018). As shown in Table 8, there has been a notable improvement in its global ranking in terms of access to/quality of financial services in the regions, such as "ease of access to credit" and "soundness of banks."

Table 6 : Number of financial services sub-sectors committed - ASEAN

Financial Services Sub-sectors	**GATS**	**AFAS 2nd Package (Consolidates)**	**AFAS 5th Package (Consolidates)**
Insurance	68	18	70
Banking	62	37	75
Capital Market	84	17	100
Others	21	10	31
Total	235	82	276

Source: Rillo (2018) from ERIA unpublished report (2012)

Table 7: Liberalisation rate for financial services sub-sectors committed

Financial Services Sub-sectors	GATS	AFAS 2nd Package (Consolidated)	AFAS 5th Package (Consolidated)
Insurance	52.19	59.56	66.03
Banking	52.76	55.20	60.40
Capital Market	51.73	37.29	54.70
Others	53.36	63.34	54.30
Total	53.76	53.85	58.86

Source: Rillo (2018) from ERIA unpublished report (2012)

Table 8: Quality of Financial Services

Countries	Ease of Access to Credit		Soundness of Banks	
	2008	2016	2008	2016
Brunei	62	86	61	91
Cambodia	107	76	125	92
Indonesia	65	26	121	72
Malaysia	15	25	50	44
Philippines	89	46	72	43
Singapore	11	3	13	8
Thailand	44	34	75	35
Vietnam	91	83	113	117
Lao PDR	-	70	-	84
Average ASEAN (Exc. Myanmar)	60.5	49.9	78.8	65.1
Brazil	77	85	24	38
India	42	39	51	75
China	99	36	108	79
South Africa	31	12	15	2
Average BICS	62.3	43	49.5	48.5

Source : Rillo (2018) from Global Competitiveness Report (GCR), WEF.

However, ASEAN still needs to catch up with other emerging countries, such as the BICS countries (Brazil, India, China, and South Africa), which only further justifies the need for ASEAN to improve their financial services quality to reap the benefit from financial globalisation (Rillo, 2018).

As a dominant source of financing for development, ASEAN banks are prevalent in other ASEAN countries. However, as shown in Table 9, the presence is not spread equally. Malaysia, Singapore, and Thailand banks have already dominated the bank's presence in the ASEAN countries, leaving wide gaps with other countries' banks.

The positive impact of ASEAN financial liberalisation should encourage ASEAN countries to further integrate their financial systems. However, as ASEAN is eager to integrate its financial sector, people will undoubtedly compare the development to the European Union (EU) because the EU is the only financially integrated region. Although ASEAN has not explicitly stated that achieving full integration is their goal, similar to the European Union, their moves resemble what the EU has done previously (Remolona et al., 2015).

On the other hand, ASEAN can take notes on what the EU has done in the past. In 1993, the EU introduced "a single passport", which resembles the QAB in ASEAN. One lesson that can be taken from the introduction is that it should be followed with an effective cross-border supervision (Remolona et al., 2015). When implementing the passport, the EU has difficulty finding the perfect risk-weight regulation on credit for the lower-rated EU countries. Thus, as the discrepancies in the ASEAN countries are similar, it is likely that ASEAN will face the same problem.

Another lesson from the EU is the urgency of having a solid cross-border resolution framework (Remolona et al., 2015; Wihardja, 2013). To illustrate, if a Malaysian bank collapses in Indonesia and potentially leads to economic catastrophe, which country should finance the bailout? Without a clear resolution, the potential dispute will delay treatment.

As the region is moving towards a more integrated financial sector, and considering the EU experience, the next question is whether ASEAN has the sound regulations to support the integration. According to the Asian Development Bank (2013), in order to further integrate, ASEAN should ensure that the sector has (i) equal access, (ii) equal treatment, and (iii) equal environment (Asian Development Bank, 2013).

Moreover, harmonizing prudential measures among ASEAN countries is essential to ensure a level playing field across the region. Wide disparities in development between countries within the region can incur significant economic costs (Siregar, 2013, as cited in Wihardja, 2013)). It is recommended to establish close coordination among regional banking supervisors, with in-depth research to map the networks and the appropriate banking integration degree.

ASEAN should reconsider the differential impacts of liberalisation on ASEAN5 and BCLMV countries, due to the wide gaps between the countries regarding financial stability, infrastructure, and regulations (Wihardja, 2013). If these conditions persists, cross-border lending tends to flow to countries with less corruption, better political stability, high-quality laws, and more efficient government policies. Additionally, financially underdeveloped countries may lack the capacity to bail out large international banks, discouraging international banks from entering these countries. Therefore, integration may not necessarily lead to capital inflows into less developed countries with generally weaker institutional qualities

Table 9: ASEAN5's Banks Presence in the ASEAN5's Region

	Bank	Ina	Ph	My	Sg	Th
Ina	BNI				B	
	Mandiri				B	
	BRI				B	
	Muamalat			B		
Ph	BDO Unibank				RO	
	Philippine National				B	
My	CIMB	S			S	S
	Maybank	S	S		V	S
	Maybank Syariah	S				
	Hong Leong				S	
	Public Bank				B	B
Sg	DBS	S	RO	B		RO
	OCBC	S		B		B
	OCBC Al – Amin			B		
	UOB	S	S	S		S
	Bank of Singapore		RO			
Th	Bangkok Bank	B	B	S	B	
	Krung Thai				B	
	Siam Commercial				B	

B is Branch, RO is Representative Office, S is Subsidiary, V is Joint Venture

Source: Bank Indonesia Presentation at ABIF Meeting, 2016

CONCLUSION

Although facing large economic disparities and each with different stages in economic development, ASEAN proceeded with its economic integration process, including liberalising trade in financial services (Ishikawa, 2021). The main hypothesis is that services trade liberalisation will increase the rate of economic growth through the more unrestrained movement of capital, technology and labour and greater competition between domestic and foreign firms in the domestic market (Hapsari & MacLaren, 2012).

In 1997, ASEAN trade and economic ministers signed the 1st package of negotiation of the AFAS 1997, mandating progressive negotiations on liberalisation of trade in services. After being initiated in 1997, AFAS has produced eight rounds of negotiation in trade in financial services, and in 2014, introduced the ABIF clause as part of AFAS. The ABIF complemented the AFAS agreement to accelerate the banking integration process. The commitment in the initial negotiation round 1997 was similar to the GATS and was more liberal in each subsequent negotiation round. In 2019, ASEAN concluded eight rounds of negotiation.

Utilizing the method from Matto (1998), the openness level of the commitment in AFAS can be quantified and formed an openness index. Thus, the effects of liberalisation on the economy can be investigated using the constructed openness index. ASEAN5 countries are the subject of this research because they have a more profound development of financial services than the BCLMV.

Using random effects panel data, the openness index positively and significantly impacts the economy. The results confirm that the ongoing liberalisation is beneficial to the ASEAN5 economy. The increasing trend in the financial services trade shows that the AFAS is on track to enhance the trade.

The positive result of the ASEAN financial liberalisation would be a good start for ASEAN policymakers to discuss how to integrate further. This research has proven that the dynamism of AFAS in the last decades is positive. However, ASEAN should learn from the EU's experience in integrating financial services for the next step in integration. Strong cross-border regulation and harmonisation among countries' regulations are required to accelerate the integration. The two topics should be included in the further discussion of ASEAN financial integration.

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