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Coordination Games: The Challenge of Pursuing a Financial Integration Project in ASEAN

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ABSTRACT:

The ASEAN Financial Integration Framework (AFIF) envisions to make possible a world where market players in the Southeast Asian region will only need to comply with a single set of rules, enjoy equal access to all markets, and receive equal treatment. To the frustration of many of ASEAN's residents, the pace of reforms in the region appears to be slow and the organization is generally seen as a failure when it comes to delivering an integrated financial market years after the project was first launched. However, unbeknownst to many, ASEAN is slowly transitioning into a rules-based regime where both hard law and soft law instruments are utilized within a single framework. Instead of lamenting the slowness of the pace of reform in the region, this paper posits that given the origins of the organization, the developments in international financial regulation elsewhere, and the unequal levels of development of the member states, it is already quite a feat for ASEAN to have come this far. With those factors in mind, a different (and less popular) conclusion is inevitable: ASEAN's crafted solutions for its coordination problems have been adequate so far, taking into consideration the complications unique to this region due to the rich diversity of cultures, histories, and customs as well as the varying levels of development of the members of the organization.

I. INTRODUCTION

In the international sphere, countries set their own rules of interaction in order to make cooperation with other states possible. At their disposal is anything between a spectrum of legally binding obligations to non-binding commitments which serve as mere instruments of coordination. Deciding the form which this cooperation will take depends on whether the benefits from entering into a hard law instrument outweigh the compliance and exit costs.

The quality and depth¹ of the commitments made will also vary. Setting the terms to facilitate international cooperation is an extremely complex exercise because of the need to strike a balance between the demands of a state's domestic stakeholders and its international partners. Another consideration is whether the commitments will be made to a single state or a multitude of states in a regional or ad hoc grouping. Legal questions only form part of the problem; what might have more weight in an international setting are the non-legal considerations such as balance of power, intra-state relationships, reputation, and domestic political processes, among others. The interplay of these various aspects will vary per individual country, resulting in different outcomes in any attempt to coordinate with an equally sovereign state or group of states.

In the Association of Southeast Asian Nations (ASEAN), these considerations are overshadowed by an institutional preference for informal mechanisms and the assertion of sovereignty in intra-ASEAN affairs. These predilections dictated the usage of mostly soft law instruments such as declarations and memoranda of understanding (MoUs) which are meant to be expressions of the organization's vision and not a binding commitment for the members. As a result, ASEAN has relied more on diplomacy than law since its establishment. Interactions between member states place greater emphasis on consensus and consultation. This has become so entrenched in its organizational culture that there is already a name for it: "the ASEAN way."

Despite these difficulties, ASEAN member states have found consensus in the establishment of the ASEAN Economic Community (AEC) last 31 December 2015 with a goal of having "a stable, prosperous and highly competitive ASEAN Economic region in which there is a free flow of goods, services, and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities."² In order to have a freer flow of capital, the members have also agreed to integrate their financial markets so that market players in the region will only need to comply with a single set of rules, enjoy equal access to all markets and corollarily, receive equal treatment.³ To achieve this objective, new rules will have to be adopted or existing ones revised across countries which are in different levels of development. This is where the challenge lies: policy coordination will have to be executed among members which would have a different starting point from which individual country regulations would have to be revised or introduced in order to build an integrated economy. Consequently, some countries

¹ Depth is "the extent to which an agreement requires states to depart from what they would have done in its absence." See Kal Raustiala, *Form and Substance in International Agreements* 99 AM. J. INT'L L. 581, 584 (2005).

² ASEAN Vision 2020, Dec. 15, 1997.

³ ASIAN DEVELOPMENT BANK, *THE ROAD TO ASEAN FINANCIAL INTEGRATION: A COMBINED STUDY ON ASSESSING THE FINANCIAL LANDSCAPE AND FORMULATING MILESTONES FOR MONETARY AND FINANCIAL INTEGRATION IN ASEAN 7* (2013).

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may require more extensive legal and institutional modifications than others.⁴ A conceived solution to this challenge is the shift to a rules-based regime which would entail the increasing use of hard law instruments over soft law. As stated in the AEC Blueprint, "In establishing the AEC, ASEAN shall act in accordance to the principles of an open, outward-looking, inclusive, and market-driven economy consistent with multilateral rules as well as ***adherence to rules-based systems for effective compliance and implementation of economic commitments.***"⁵

The goal of the ASEAN Financial Integration Framework (AFIF) is to create a single and integrated financial market in the region by establishing the necessary regional financial infrastructure that will enable capital to move across borders with ease. To do this, new institutions will have to be created and laws and regulations which place restrictions and barriers to the free movement of capital will have to be removed. Essentially, this would require the member states to interact more closely than they have been accustomed to. This process begins from the harmonization and standardization of the rules and regulations with respect to financial intermediation to making sure that such standards remain up to date and responsive to rapid changes in the industry. Accomplishing the end goal of the AFIF is a tall order for ASEAN member states since for them, it does not only entail the harmonization of rules; it also requires them to take a leap faith and push past their accustomed limits to external interactions.

This challenge is not unique to ASEAN. In today's highly integrated world, the so-called 'Westphalian' concept of sovereignty is being challenged.⁶ Monopoly in the exercise of sovereign power is no longer possible.⁷ States can no longer effectively govern in isolation nor refuse to cooperate with other states.⁸ Financial regulation, which used to be the sole province of a particular territory, now requires coordination between independent nation-states due to the 'internationalization'⁹ of once-fragmented domestic financial markets made possible by technological innovations and corporate expansion.¹⁰ The world is now faced with a new concept of sovereignty where states are looked upon as actors with "the right and the capacity to participate in the international institutions that allow their members, working together, to accomplish the ends that individual governments could once accomplish alone"¹¹ in contrast to simply viewing states as autonomous agents which have the "right to be left alone, to exclude, and to be free from external meddling or interference."¹²

The name of the game now is how to efficiently and effectively manage this market

⁴ Chris Brummer, *How International Financial Law Works (And How It Doesn't)* 99 GEO. L. J. 257, 269 (2011).

⁵ ASEAN, ASEAN ECONOMIC COMMUNITY BLUEPRINT 5 (2008); Emphasis supplied.

⁶ Anne-Marie Slaughter, *Sovereignty and Power in a Networked World Order* 40 STAN. J. INT'L L. 283, 284 (2004).

⁷ Wolfgang H. Reinicke & Jan M. Witte, *Interdependence, Globalization and Sovereignty: The Role of Non-binding International Legal Accords*, in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM 75, 82 (Dinah Shelton ed., 2000).

⁸ Slaughter, *supra* note 6, at 285; See Reinicke & Witte.

⁹ T.M. Rybczynski, *The Internationalization of Finance and Business* 23 BUS. ECON. 14, 14 (1988). (Rybczynski identifies three main strands to describe the internationalization of finance which are: (1) a large increase in the flow of funds across national frontiers; (2) a marked increase in the number of foreign financial institutions in the primary financial centers; and (3) a sizeable increase in the holdings of foreign financial and real assets owned directly and indirectly by residents of various countries.)

¹⁰ Brummer, *supra* note 4, at 266.

¹¹ Slaughter, *supra* note 6, at 286.

¹² *Id.* at 283.

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interdependence by ensuring that the total joint costs that will be incurred from increased coordination with other sovereigns are outweighed by the total joint benefits to be had from such activity.¹³ De Guzman (2005) adds that it is not material if the cost to one party is greater as long as compliance produces net benefits to both parties.¹⁴ These premises are rooted in the presumption that states are rational and will always act in a way that will maximize their interests.¹⁵ While this paper does not wholly reject this premise, it posits that the evolution of the financial integration movement in ASEAN is not bounded on rationality alone. Rather, it is also governed by the organization's path dependence in an admixture of endogenous and exogenous factors which were both necessary and inevitable due to the international nature of trade and financial regulation.

The primary goals of this paper are to address the popular perception that no significant progress is being made in AFIF¹⁶ and to establish that ASEAN is slowly transitioning into a rules-based regime, though not necessarily composed of hard law instruments alone. Instead of lamenting the slowness of the pace of reform in the region, this paper posits that given the origins of the organization, the developments in international financial regulation elsewhere, and the unequal levels of development of the member states, it is already quite a feat for ASEAN to have come this far. To do this, the paper will discuss the crafted solutions for ASEAN's coordination problems and explain why they have been adequate, taking into consideration the complications unique to this region due to the rich diversity of cultures, histories, and customs as well as the varying levels of development of the members of the organization. The analysis approach that is adopted for this paper is fairly simple and will largely gloss over the intricacies behind the decision-making process of the ASEAN officials. However, it is a useful starting point for scholars who want to study the decision-making dynamics in the region.

The rest of the paper is structured as follows. Part II will provide a background on ASEAN which will include the historical background of the organization and the origins of the financial integration movement in the region. Part III will then analyze the concepts and processes utilized by ASEAN to manage regional economic cooperation which eventually evolved into a full-blown regional financial integration. The section shall also discuss the factors which have led to the adoption of such concepts and processes. Lastly, the section shall also extensively dwell on the culmination of the AFIF into a dual-approach structure utilizing both hard law and soft law instruments and assess whether ASEAN has managed to comply with its objective of adhering to "rules-based systems for effective compliance and implementation of economic commitments". Part IV concludes.

II. A GLIMPSE INTO THE ORIGINS OF ASEAN AND ITS FINANCIAL INTEGRATION MOVEMENT

When ASEAN was established in 1967, its founding states laid witness to turbulent events in the

¹³ Brummer, *supra* note 4, at 269.

¹⁴ This is owing to the non-zero sum nature of sanctions in the international arena. See Andrew T. Guzman, *The Design of International Agreements* 16 EUR. J. INT'L L. 579, 588 (2005).

¹⁵ JACK L. GOLDSMITH AND ERIC A. POSNER, *THE LIMITS OF INTERNATIONAL LAW* 3 (2005).

¹⁶ See Ravi Menon, Managing Director, Monetary Auth. of Sing., Keynote Address at ASEAN Banking Council: ASEAN Financial Integration: Where are we, Where Next? (Jun. 12, 2015); See also Wei Han Wong, *Asean financial integration: 'Good idea, poor progress'*, STRAITS TIMES (Jun. 20, 2015), <http://www.straitstimes.com/business/asean-financial-integration-good-idea-poor-progress>; Rumi Hardasmalani, *Bankers lament slow pace of ASEAN Integration*, CHANNELNEWS ASIA (May 14, 2015) <http://www.channelnewsasia.com/news/business/singapore/bankers-lament-slow-pace/1848728.html>; ASIA HOUSE, FINANCIAL INTEGRATION AND CAPITAL MARKET DEVELOPMENT CONTINUES 'IN THE ASEAN WAY' (2015) <http://asiahouse.org/financial-integration-capital-market-development-continues-asean-way/>.

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region such as the Konfrontasi between Indonesia and Malaysia, Suharto's rise to power, Singapore's separation from Malaysia, and the ongoing Vietnam War. Some parts of the region were highly unstable and because of this, security was a top concern of its population. In an effort to establish a framework for political and diplomatic cooperation, the founding nation states of Indonesia, Malaysia, Philippines, Singapore, and Thailand established the ASEAN in a document called the Bangkok Declaration of 1967. This move was meant to usher in a new type of engagement between the aforementioned states in order to prevent any volatile situation between them from simmering into conflicts. The maintenance of order and security in the region was the primary consideration for the organization's existence.¹⁷

With this as a background, it can be argued that the establishment of ASEAN was successful only because it involved insignificant sovereignty costs. The founding member states made sure of that by structuring ASEAN as an intergovernmental organization whose purpose is to merely coordinate regional policies. It did not possess any enforcement powers. At that time, it must be remembered that for most member states, the acquisition of independence was an event from a not-so distant past. It is thus understandable that the idea of having to give up a part of their newly-acquired sovereignty was just not acceptable.¹⁸ As a result, the principle of national sovereignty dictated the level of engagement and cooperation within the said organization. This strong sense of sovereignty and the events which led to the creation of ASEAN created an environment of distrust which heavily influenced how the member states interacted with each other.¹⁹

Economic cooperation was beset by the same problems. Distrust between the members were so high that as an example, the negotiations of the 1977 ASEAN Preferential Trading Agreement (PTA) nearly broke down due to disagreements over the lifting of tariffs on snow ploughs in a mostly tropical region

¹⁷ RODOLFO C. SEVERINO, *SOUTHEAST ASIA IN SEARCH OF AN ASEAN COMMUNITY: INSIGHTS FROM THE FORMER ASEAN SECRETARY-GENERAL 3* (2006).

¹⁸ This sentiment was strongly entrenched within ASEAN. For example, the Preamble of the 1967 ASEAN Declaration, Aug. 8, 1967 states:

*"CONSIDERING that the countries of South East Asia share a primary responsibility for strengthening the economic and social stability of the region and ensuring their peaceful and progressive national development, and **that they are determined to ensure their stability and security from external interference in any form or manifestation in order to preserve their national identities in accordance with the ideals and aspirations of their peoples;**" (Emphasis supplied);*

The 1976 Treaty of Amity and Cooperation in Southeast Asia, Feb. 24, 1976 goes even further. Article 2 of the said Treaty states that:

"ARTICLE 2

In their relations with one another, the High Contracting Parties shall be guided by the following fundamental principles:

- a. Mutual respect for the independence, sovereignty, equality, territorial integrity and national identity of all nations;
- b. The right of every State to lead its national existence free from external interference, subversion or coercion;
- c. Non-interference in the internal affairs of one another;
- d. Settlement of differences or disputes by peaceful means;
- e. Renunciation of the threat or use of force;
- f. Effective cooperation among themselves."

¹⁹ Michael Ewing-Chow and Hsien-Li Tan, *The Role of the Rule of Law in ASEAN Integration 1* (Eur. Univ. Inst. – Robert Schuman Ctr. For Advanced Studies Working Paper 2013/16, 2013).

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like Southeast Asia.²⁰

As a way to diffuse the distrust between the members, ASEAN devised a new type of diplomacy which is unique to this region called “the ASEAN way.” Rooted from the Malay cultural practices of *musjawarah* and *mufukat*, the ASEAN way emphasizes consensus-building and consultation among the members in a group. In meetings or gatherings where decisions need to be made, a consensus had to be reached among all the members as much as possible. If a stumbling block was reached and there were points of disagreement which simply could not be resolved, these would be set aside first and the meeting will proceed to focus on the matters which the group finds collectively agreeable. The matters shelved for that meeting shall be discussed again during the next one. It is to be noted that even if a consensus has been reached on a certain matter or issue, this does not automatically bind the members. Utmost flexibility is given to implement the measure agreed upon as they see fit. They even have the liberty not to implement it all.²¹

The road towards the AEC has not been a smooth one. Even before financial integration became the battle cry of the region, ASEAN member states already struggled with the acceptance of the idea of cooperating with each other to further economic development. Thus, while one of the declared purposes of ASEAN under the 1967 Bangkok Declaration was the acceleration of economic growth through joint partnership of all the members,²² the earliest record of this mandate being operationalized was in a 1976 Joint Communiqué where the ASEAN heads of government convened a meeting of the economic ministers to devise measures that will foster closer economic cooperation.²³

The first major breakthrough on ASEAN economic cooperation was not until 1992 with the adoption of the 1992 Framework Agreement on Enhancing Economic Cooperation (Framework Agreement). While it is already considered ambitious in terms of furthering economic cooperation in ASEAN,²⁴ the contents of the document itself are broadly-worded and vague.²⁵ Rather than offering concrete steps and measures

²⁰ An agreement on it was eventually reached but only after several days of intense negotiations. This story might be apocryphal. See Jean-Pierre Lehmann, *From battlefield to marketplace*, THE STRAITS TIMES (Jan. 23, 2016) <http://www.straitstimes.com/opinion/from-battlefield-to-marketplace>>; However, the 1977 ASEAN Preferential Trading Agreement, Feb. 24, 1977 does include the preferential treatment of imports of snowploughs. See Michael Plummer, Peter Petri & Fan Zhai, *Assessing the Impact of ASEAN Economic Integration on Labour Markets 2* (Int'l Lab. Org. Asia-Pacific Working Paper Series, 2014).

²¹ ESTRELLA D. SOLIDUM, *THE POLITICS OF ASEAN: AN INTRODUCTION TO SOUTHEAST ASIAN REGIONALISM* 97 (2003).

²² This can be seen in the generally-worded statements in the earlier ASEAN instruments. An example of this is found in the 1967 ASEAN Declaration, Aug. 8, 1967 where it states that one of the declared purposes of the organization is:

“1. To accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations.” (1967 ASEAN Declaration, Aug. 8, 1967).

²³ Joint Communiqué of the First ASEAN Heads of Government Meeting, Feb. 23-24, 1976, ¶ 9 http://www.asean.org/?static_post=joint-communicue-the-first-asean-heads-of-government-meeting-bali-23-24-february-1976.

²⁴ PAUL J. DAVIDSON, *ASEAN: THE EVOLVING LEGAL FRAMEWORK FOR ECONOMIC COOPERATION* 68 (2002).

²⁵ This is only reflective of the earlier-mentioned characteristic of ASEAN instruments as being worded in a general manner. In the Framework Agreement, for example, it provides:

“Member States shall endeavour to strengthen their economic cooperation through an outward-looking attitude so that their cooperation contributes to the promotion of global trade liberalization.” (Framework Agreements on Enhancing Economic Cooperation, Jan. 28, 1992)

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to enhance economic cooperation, it is written more like a general covenant to cooperate in the areas enumerated under the agreement.²⁶ It also enumerated particular areas of cooperation but member states were expected to come up with specific measures to facilitate economic cooperation in the respective areas.²⁷ More importantly, the Framework Agreement is not legally binding. While member states have an obligation under it to participate in all intra-ASEAN economic arrangements,²⁸ implementation is left to their discretion.²⁹

In 1997, the ASEAN Vision 2020 was adopted which stipulated the year 2020 as the target year for ASEAN's goal of having a regionally integrated economy.³⁰ The declaration of this goal was an important milestone as it signaled the region's move from merely promoting economic cooperation to the promotion of the region itself as an efficient and attractive investment destination.³¹ In financial services specifically, the member states have agreed to "promote financial sector liberalization and closer cooperation in money and capital market, tax, insurance and custom matters as well as closer consultations in macroeconomic and financial policies."³²

The events leading up to and the aftermath of the 1997 Asian Financial Crisis overshadowed the adoption of this important document, however. The failure of ASEAN to collectively respond to the said crisis led a lot of people within the region to criticize its irrelevance both internally and externally. The Report of the ASEAN Eminent Persons Group on Vision 2020 also expressed doubt on the "collective readiness and will of ASEAN states to meet even sterner challenges in the 21st century."³³ The said period also gave rise to a sentiment against a heavy dependence on the banking sector and a corollary push towards the development of the capital markets instead.³⁴

http://www.asean.org/storage/images/2012/Economic/AFTA/Common_Effective_Preferential_Tariff/Framework%20Agreements%20on%20Enhancing%20ASEAN%20Economic%20Cooperation%20.pdf>

²⁶ In the area of finance and banking for example, this is what has been adopted:

"1. Member States shall strengthen and develop further ASEAN economic cooperation in the field of capital markets, as well as find new measures to increase cooperation in this area.

2. Member States shall encourage and facilitate free movement of capital and other financial resources, including further liberalisation of the use of ASEAN currencies in trade and investments, taking into account their respective national laws, monetary controls and development objectives." (Framework Agreements on Enhancing Economic Cooperation, Jan. 28, 1992, Article 2(c))

²⁷ Davidson, *supra* note 24.

²⁸ *Supra* note 25, at Article 1(3).

²⁹ Article 1(3) of the Framework Agreements on Enhancing Economic Cooperation, Jan. 28, 1992 states: "...in the implementation of these economic arrangements, two or more Member States may proceed first if other Member States are not ready to implement these arrangements."

³⁰ *Supra*, note 2.

³¹ *Supra*, note 2, at Article 4(c).

³² *Supra*, note 2.

³³ Report of the ASEAN Eminent Persons Group on Vision 2020, http://www.asean.org/?static_post=report-of-the-asean-eminant-persons-group-epg-on-vision-2020-the-people-s-asean.

³⁴ ASIAN POLICY FORUM, POLICY RECOMMENDATIONS FOR PREVENTING ANOTHER CAPITAL ACCOUNT CRISIS 7, <http://www.adb.org/sites/default/files/publication/157749/adbi-apfrs2.pdf>; ASIAN POLICY FORUM, POLICY RECOMMENDATIONS FOR DESIGNING NEW AND BALANCED FINANCIAL MARKET STRUCTURES IN POST-CRISIS ASIA at 15-23, <http://www.adb.org/sites/default/files/publication/157750/adbi-apfrs3.pdf>; Ilhyock Shim, *Development of Asia-Pacific*

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In 2003, ASEAN officially declared the creation of the AEC through the Bali Concord II. Coinciding with this, the Roadmap for Monetary and Financial Integration of ASEAN (RIA-Fin) was also adopted which delineated an action plan for integration in four areas, namely: (1) Capital Market Development; (2) Liberalization of Financial Services; (3) Capital Account Liberalization; and (4) ASEAN Currency Cooperation. Out of these four areas, only capital market development had significant developments. Based on this Roadmap, ASEAN Capital Markets Forum (ACMF) was created. The ACMF is a group comprising of capital market regulators from all ten (10) ASEAN member states set up by the ASEAN Finance Ministers in 2004³⁵ “initially focused on harmonization of rules and regulations before shifting towards more strategic issues to achieve greater integration of the region’s capital markets under the AEC Blueprint 2015.”³⁶ It administers programs related to the development of the region’s capital markets such as the ASEAN Trading Link, ASEAN Disclosure Standards, ASEAN Corporate Governance Scorecard, and Bond Market Development.

The AFIF followed almost ten years later as a result of a joint study conducted by the Asian Development Bank (ADB) and ASEAN.³⁷ This study served as the foundational document for the framework. The AFIF is composed of three separate work streams in the following areas: banking, insurance, and capital markets. Within each industry, one will find a host of measures or action plans that need to be completed in order to achieve the end goal of financial integration. Figure 1 shows the AFIF structure.

corporate bond and securitisation markets in WEATHERING FINANCIAL CRISES: BOND MARKETS IN ASIA AND THE PACIFIC 5 (BIS Papers No. 63, 2012);

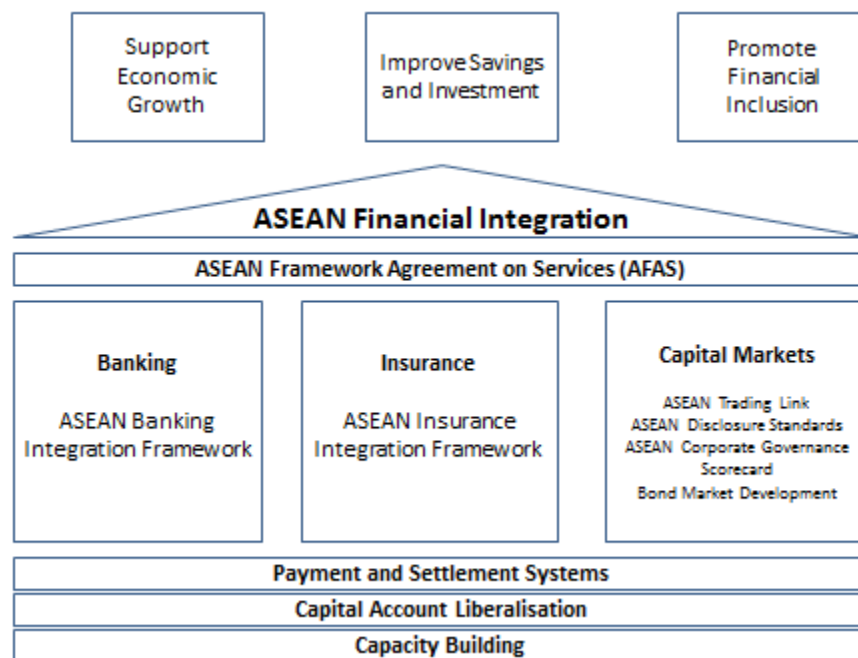
MASAHIRO KAWAI, RICHARD NEWFARMER & SERGIO L. SCHMUKLER, FINANCIAL CRISES: NINE LESSON FROM EAST ASIA 11 (2003).

³⁵ Joint Ministerial Statement 8th ASEAN Finance Ministers’ Meeting, Apr. 7, 2004, ¶ 9, <http://www.asean.org/joint-ministerial-statement-8th-asean-finance-ministers-meeting-singapore/>.

³⁶ See http://www.theacmf.org/ACMF/webcontent.php?content_id=00001.

³⁷ *Supra*, note 3.

Figure 1. The ASEAN Financial Integration Framework Diagram.³⁸



Source: ASEAN SENIOR LEGAL COMMITTEE, SUMMARY OF THE ACHIEVEMENTS OF THE ASEAN FINANCIAL INTEGRATION http://www.bnm.gov.my/documents/2015/20150321_Summary_of%20Achievements_final.pdf

The first three boxes in the diagram identifies the benefits that ASEAN financial integration will bring. The premise is that having a strong regional banking network in the region, robust and competitive insurance industry, and a deep and liquid regional capital market will help support economic growth in the region, spur a more efficient allocation of savings into productive investments, and extend financial intermediation to a wider segment of the population.³⁹ Figure 1 illustrates that ASEAN Framework Agreements on Services (AFAS) is the umbrella agreement for all the work streams. However, this diagram is slightly misleading because some of the initiatives listed under the capital market work stream are not under the AFAS at all since they do not have anything to do with opening market access. That being said, the AFAS does include opening market access to financial services relating to the capital market such as those performed by underwriters, brokers, and dealers (among others). However, majority of the initiatives under the capital market stream pertain to initiatives that aim to create an enabling environment for regional integration through the establishment of common standards or harmonization of rules. To date, three important ACMF initiatives have made significant strides. These are: the cross-border offering of ASEAN Collective Investment Schemes (CIS), cross-border fund raising through a streamlined review of prospectuses, and the ranking of ASEAN publicly-listed companies (PLCs) in corporate governance.

Banking integration, on the other hand, focuses on opening the domestic market to banks from other member states. Under the Protocol to Implement the 6th Package of Commitments on Financial

³⁸ ASEAN SENIOR LEGAL COMMITTEE, SUMMARY OF THE ACHIEVEMENTS OF THE ASEAN FINANCIAL INTEGRATION http://www.bnm.gov.my/documents/2015/20150321_Summary_of%20Achievements_final.pdf.

³⁹ *Id.*

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Services under the AFAS (Protocol 6), member states are allowed to provide market access to foreign ASEAN banks on a bilateral or multilateral basis.⁴⁰ Such banks, however, have to first meet the requirements of a “Qualified ASEAN Bank” (QAB). Several countries have already made bilateral arrangements to implement the ASEAN Banking Integration Framework (ABIF).⁴¹ Under these arrangements, the parties can identify parameters under which a QAB can operate under their respective jurisdictions. Apart from market access, the ABIF also provides for the regional harmonization of licensing requirements and prudential regulations⁴² but no concrete steps have been taken on this yet.

Insurance integration is following the same trajectory as banking by liberalizing market access to other member states using the AFAS.⁴³ However, instead of adopting a piecemeal approach by allowing bilateral agreements first, ASEAN went ahead and fully liberalized the cross-border supply of international Marine, Aviation, and Transit Insurance except for Indonesia and Myanmar.⁴⁴ There is also an ongoing effort by the ASEAN Insurance Regulators’ Meeting (AIRM) to develop a regulatory and supervisory framework for insurance based on the insurance core principles promulgated by the International Association of Insurance Supervisors (IAIS).⁴⁵ However, no further details were publicly available with respect to the progress of this initiative.

III. SOLVING ASEAN’S COORDINATION PROBLEMS: FROM CONSENSUS-BUILDING TO HARD LAW INSTRUMENTS

The brief overview provided by the previous section on the evolution of the financial integration movement showed us that ASEAN’s movement towards a rules-based approach did not lead to a complete abandonment of the use of informal mechanisms to coordinate in certain matters. Instead, what resulted was the creation of a dual-approach structure with one approach pursuing integration by opening market access through the utilization of hard law instruments while the other approach is pursuing integration through regulatory harmonization and coordination by the use of loose informal arrangements more commonly known as soft law instruments.

ASEAN, as it exists today, is a different entity to what it was at the time of its establishment almost fifty years ago. It came into existence amidst an environment of distrust which heavily influenced how the member states interacted with each other.⁴⁶ Individual sovereignty was closely guarded and even a hint of its reduction in intra-state engagements was avoided.⁴⁷

⁴⁰ Protocol to Implement the 6th Package of Commitments on Financial Services under the ASEAN Framework Agreement on Services, ¶ 5.

⁴¹ Malaysia has already signed bilateral agreements with Indonesia, Philippines, and Thailand.

⁴² *Supra*, note 3 at 11-12.

⁴³ Protocol to Implement the 7th Package of Commitments on Financial Services under the ASEAN Framework Agreement on Services.

⁴⁴ *Id.*; ASEAN ECONOMIC COMMUNITY 2025 STRATEGIC ACTION PLANS (SAP) FOR FINANCIAL INTEGRATION FROM 2016-2025.

⁴⁵ Joint Statement of the 2nd ASEAN Finance Ministers’ and Central Bank Governors’ Meeting (AFMGM), Vietniane, Lao PDR, 4 April 2016

⁴⁶ Michael Ewing-Chow and Hsien-Li Tan, *The Role of the Rule of Law in ASEAN Integration 1* (Eur. Univ. Inst. – Robert Schuman Ctr. For Advanced Studies Working Paper 2013/16, 2013).

⁴⁷ This sentiment was strongly entrenched within ASEAN. For example, the Preamble of the 1967 ASEAN Declaration, Aug. 8, 1967 states:

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As a response to this distrust, intra-state relationships were first cultivated informally. Open channels of communication and constant consultations commonly described as the ASEAN way characterized the early interactions between the member states. These frequent interactions enabled them to learn about each other's policy preferences in a non-hostile environment.⁴⁸ Building consensus in this manner was important in the process of strengthening group solidarity and reinforcing the pillars of trust between the member states.⁴⁹ The ASEAN way was also helpful in fostering long-term relationships among the members which could possibly negate the need for legally binding commitments in order to implement the measures adopted.⁵⁰ After all, in contrast to the European Union's (EU) preference for formal institutions, ASEAN places higher importance on personal relationships.⁵¹ This turned out to be an essential process in shaping the member states' policies towards the same direction, which is helpful in finding solutions for problems of coordination.⁵²

These views certainly have merit if ASEAN's problems were that of pure coordination which can be solved by reinforcing trust and ensuring the constant flow of information.⁵³ However, this is a too simplistic picture of the organization and does not wholly reflect the realities on the ground. It may be conceded that the ASEAN way may have helped in getting the earlier documents on economic cooperation like the Framework Agreement and the 1997 ASEAN Vision 2020 adopted. However, the non-binding nature of these agreements and the flexibilities they offer in terms of implementation soften their impact

"CONSIDERING that the countries of South East Asia share a primary responsibility for strengthening the economic and social stability of the region and ensuring their peaceful and progressive national development, and **that they are determined to ensure their stability and security from external interference in any form or manifestation in order to preserve their national identities in accordance with the ideals and aspirations of their peoples;**" (Emphasis supplied);

The 1976 Treaty of Amity and Cooperation in Southeast Asia goes even further. Article 2 of the said Treaty states that:

"ARTICLE 2

In their relations with one another, the High Contracting Parties shall be guided by the following fundamental principles:

- a. Mutual respect for the independence, sovereignty, equality, territorial integrity and national identity of all nations;
- b. The right of every State to lead its national existence free from external interference, subversion or coercion;
- c. Non-interference in the internal affairs of one another;
- d. Settlement of differences or disputes by peaceful means;
- e. Renunciation of the threat or use of force;
- f. Effective cooperation among themselves."

⁴⁸ Slaughter, *supra* note 6 at 315.

⁴⁹ *Id.*

⁵⁰ Edith Brown Weiss, *Conclusions: Understanding Compliance with Soft Law, in* COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM 535, 539 (Dinah Shelton ed., 2000).

⁵¹ Davidson, *supra* note 24, at 42.

⁵² Brummer, *supra* note 4.

⁵³ Brummer, *supra* note 4.

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and reduce any distributive consequences they might have had.⁵⁴ The ASEAN way's inadequacy can also be seen if we consider the dynamics of negotiations in a multilateral setting. Negotiations in this instance will necessarily be more complicated since the member states will have different (and divergent) regulatory philosophies and prioritized issues.⁵⁵ Thus, even if all member states desire to cooperate and see the benefits of doing so, reaching a consensus might be difficult if they can't even find a common starting position from which to negotiate.⁵⁶ In financial integration specifically, the objective to harmonize rules presupposes that the countries participating in the harmonization exercise already have more or less similar rules. This, however, cannot be presumed in ASEAN. Neither can it be assumed that all member states have rules in the first place. For example, the Ha Noi Action Plan (HAP) mandated the establishment of mechanisms for the cross-listing of SMEs among ASEAN capital markets.⁵⁷ In the case of the CMLV countries⁵⁸ (except Cambodia), at the time the HAP was adopted, most of these new members did not even have a functioning stock exchange.

Another complication is the member states' varying levels of development. In ASEAN, countries such as Singapore, which has a gross domestic product (GDP) per capita of 55,182US\$ and Cambodia, which has a GDP per capita of 1,037US\$ co-exist.

Table 1. GDP Per Capita at Current Market Prices in Millions of USD, 2006-2013 (in US \$ Million)⁵⁹

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Brunei Darussalam | 31,452 | 33,191 | 38,621 | 28,454 | 32,063 | 42,431 | 42,445 | 39,679 |
| Cambodia | 515 | 601 | 827 | 735 | 785 | 882 | 950 | 1,037 |
| Indonesia | 1,636 | 1,910 | 2,244 | 2,359 | 2,988 | 3,498 | 3,563 | 3,460 |
| Lao PDR | 576 | 719 | 882 | 913 | 1,079 | 1,262 | 1,443 | 1,548 |
| Malaysia | 6,160 | 7,166 | 8,393 | 7,216 | 8,515 | 9,962 | 10,346 | 10,420 |
| Myanmar ⁶⁰ | 233 | 333 | 436 | 538 | 706 | 853 | 885 | 888 |
| Philippines | 1,408 | 1,717 | 1,917 | 1,829 | 2,127 | 2,339 | 2,568 | 2,707 |
| Singapore | 33,580 | 39,224 | 39,724 | 38,557 | 46,570 | 52,865 | 54,007 | 55,182 |
| Thailand | 3,162 | 3,743 | 4,106 | 3,947 | 4,743 | 5,116 | 5,391 | 5,679 |
| Vietnam | 798 | 918 | 1,165 | 1,232 | 1,338 | 1,543 | 1,755 | 1,909 |
| ASEAN ⁶¹ | 1,955 | 2,309 | 2,647 | 2,610 | 3,162 | 3,619 | 3,781 | 3,832 |

Source: THE ASEAN SECRETARIAT, ASEAN STATISTICAL YEARBOOK 2014 40 TBL.IV.4 (2015).

Even if the assumption is made that most member states share the same policy preferences, some

⁵⁴ CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21ST CENTURY 134 (2015).

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ Ha Noi Plan of Action, Dec. 5, 1997, http://www.asean.org/?static_post=hanoi-plan-of-action.x

⁵⁸ Namely, Cambodia, Laos, and Myanmar, and Vietnam.

⁵⁹ THE ASEAN SECRETARIAT, ASEAN STATISTICAL YEARBOOK 2014 40 (2015). The source for the figures is the ASEAN Macroeconomic Database, computed based on data submitted by countries and their websites.

⁶⁰ Myanmar figures were calculated using the exchange rates used in the IMF-WEO Database of October 2014.

⁶¹ As a proxy, the combined GDP of ASEAN was computed as the sum of GDP at current market price of ASEAN Member Countries.

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of them may simply not have the resources nor the capacity to implement the changes demanded by the commitments under the AFIF.⁶² For example, Yean and Das (2015) talked about the scarcity of resources in Vietnam as the cause of the country's failure to implement some of its commitments in the AEC.⁶³ These obstacles cannot be cleared through mere dialogue and consensus-building alone.

Recognizing such realities, ASEAN came up with was formally called the "ASEAN minus X" formula which made possible the adoption of agreements even on areas where member states were on disparate levels of development. Through this mechanism, one or more member states were allowed to withhold their participation in the intra-ASEAN economic arrangements if they are not yet ready.⁶⁴ This also addressed concerns on national sovereignty since it gave member states absolute discretion in deciding when they will implement the measures adopted.⁶⁵ While such arrangement definitely made the exit costs "inexpensive",⁶⁶ it can be argued that this was a necessary solution to ASEAN's dilemma of having ten members at different stages of economic development. In order to facilitate economic cooperation in a region where some member states were just starting to build the institutions that will facilitate economic development and others which were already at an advanced stage of financial and economic maturity, commonalities which will enable parties to implement select measures on a piecemeal basis should be found somewhere.

Indeed, the formula played an important role in accelerating the pace of reforms in ASEAN such as services liberalization and economic cooperation.⁶⁷ It was first used in the Framework Agreement where it expressly gave member states absolute discretion when to implement the agreement.⁶⁸ It is also present in the AFAS, a document which was adopted in 1995 with the goal of enhancing intra-ASEAN cooperation by extending to other member states commitments which are beyond those inscribed under their respective General Agreement on Trade in Services (GATS) commitments and by according preferential treatment to each other on a most-favored nation (MFN) basis.⁶⁹ This was supposed to place all member states on an equal footing because at the time the AFAS was signed, not all members were part of the GATS yet. Similar to the Framework Agreement, Article II of the AFAS also provides that "two or more Member States may proceed first if other Member States are not ready to implement these

⁶² Brummer, *supra* note 4.

⁶³ Tham Siew Yean & Sanchita Basu Das, *The ASEAN Economic Community and Conflicting Domestic Interests: An Overview* 32 J. SOUTHEAST ASIAN ECONOMIES 189, 197 (2015).

⁶⁴ *Supra* note 25, at Article 1(3). This is also reiterated in other agreements like in the Ministerial Understanding on ASEAN Cooperation in Finance, Mar. 1, 1997, Article 5(2) http://www.asean.org/storage/images/2012/Economic/AFMM/Agreement_on_Finance/Ministerial%20Understanding%20on%20ASEAN%20Cooperation%20in%20Finance%20%281997%29.pdf.

⁶⁵ Article 1(3) of the Framework Agreements on Enhancing Economic Cooperation, Jan. 28, 1992 states: "...in the implementation of these economic arrangements, two or more Member States may proceed first if other Member States are not ready to implement these arrangements."

⁶⁶ Brummer, *supra* note 4, at 271.

⁶⁷ David Chin Soon Shiong, *ASEAN's Journey Towards Free Trade*, in ECONOMIC DIPLOMACY: ESSAYS AND REFLECTIONS BY SINGAPORE'S NEGOTIATORS 209, 216 (Chin L. Lim and Margaret Liang eds., 2010).

⁶⁸ Article 1(3) of the Framework Agreements on Enhancing Economic Cooperation, Jan. 28, 1992 states: "...in the implementation of these economic arrangements, two or more Member States may proceed first if other Member States are not ready to implement these arrangements."

⁶⁹ ASEAN Framework Agreements on Services, Dec. 15 1995, Article 4, http://www.asean.org/?static_post=asean-framework-agreement-on-services.

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[cooperation] arrangements.”⁷⁰

This progress was overshadowed by the 1997 Asian Financial Crisis. After the dust has settled, people began to demand for more concrete measures such as the development of the capital markets to reduce the region's dependency on the banking system.⁷¹ As mentioned earlier, one such measure was the 2003 Ria-FIN where capital market development was pursued through the harmonization of rules relating to the passporting of funds, disclosure standards and cross-border capital-raising. Agreements reached in relation to these areas were concluded in the form of MoUs. While the MoUs no longer contained the ASEAN minus X formula, there was an explicit understanding that member states who are ready to cooperate on specific sectors could go ahead first. Such understanding was formally called the “2+x” approach.⁷²

Compared to treaties, MoUs are considered less formal international instruments that contain wordings and phrases which express an intention that is not binding under international law.⁷³ While the ACMF's reasons for the adoption of MoUs to govern the capital market development process are not publicly known, this was certainly not unusual since international financial agreements were being promulgated as non-binding agreements between regulatory agencies elsewhere.⁷⁴ The same trend applies to international securities regulation in particular.⁷⁵ To quote Karmel and Kelly (2009):

“The long history of national soft law securities regulation has continued in the international sphere out of necessity. Neither treaty law nor customary international law can provide the speed, flexibility, and expertise that international securities regulation requires. The treaty process is not easy. Typically treaties take years to conclude. Thereafter, they need to be ratified by a number of countries in order to enter into force. Ratification can be a long and complicated process in many countries and may often not occur.”⁷⁶

Also, most of the ASEAN member states are members of international standard-setting agencies such as International Organization of Securities Commissions (IOSCO).⁷⁷ Only Singapore and Indonesia have

⁷⁰ *Id.*

⁷¹ ASIAN POLICY FORUM, POLICY RECOMMENDATIONS FOR PREVENTING ANOTHER CAPITAL ACCOUNT CRISIS 7, <http://www.adb.org/sites/default/files/publication/157749/adbi-apfrs2.pdf>; ASIAN POLICY FORUM, POLICY RECOMMENDATIONS FOR DESIGNING NEW AND BALANCED FINANCIAL MARKET STRUCTURES IN POST-CRISIS ASIA at 15-23, <http://www.adb.org/sites/default/files/publication/157750/adbi-apfrs3.pdf>; Ilhyock Shim, *Development of Asia-Pacific corporate bond and securitisation markets in WEATHERING FINANCIAL CRISES: BOND MARKETS IN ASIA AND THE PACIFIC 5* (BIS Papers No. 63, 2012);

MASAHIRO KAWAI, RICHARD NEWFARMER & SERGIO L. SCHMUKLER, *FINANCIAL CRISES: NINE LESSON FROM EAST ASIA* 11 (2003).

⁷² Press Statement by the Chairperson of the 9th ASEAN Summit and the 7th ASEAN Summit in Bali, Indonesia (7 October 2003) para 20 <http://www.asean.org/?static_post=press-statement-by-the-chairperson-of-the-9th-asean-summit-and-the-7th-asean-3-summit-bali-indonesia-7-october-2003> accessed 23 February 2016

⁷³ Anthony Aust, *Modern Treaty Law and Practice* (3rd edn, Cambridge University Press 2013) 28.

⁷⁴ Brummer, *supra* note 54, at 3.

⁷⁵ See Raustiala, *supra* note 1, at 600; Roberta S. Karmel and Claire R. Kelly, ‘The Hardening of Soft Law in Securities Regulation’ (2009) 34 BJIL 883, 890-891.

⁷⁶ *Id.*, at 891.

⁷⁷ As at the time this paper was being drafted, only Myanmar, Cambodia, and Laos are not yet ordinary members of IOSCO.

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membership in the Basel Committee on Banking Supervision (Basel) but all the other member states impose the Basel requirements⁷⁸ on regulated entities within their respective jurisdictions. With respect to the IAIS, only Laos and Myanmar have yet to become members. As participants in the international financial ecosystem and members of such organizations, there can be no doubt that such international trends have also influenced their decision to order their relationship in this manner.

Moreover, this MoU structure perfectly suited the predisposition of ASEAN to favor informal agreements over hard law instruments, as discussed earlier in the paper. However, such structure was not replicated in ASEAN's other financial integration arrangements. Ten years after the capital market development project was launched, ASEAN adopted a comprehensive plan called the AFIF to integrate the region's financial markets. Interestingly enough, banking and insurance were designed to take a different approach by utilizing hard law instruments over soft law ones. Under the framework, the AFAS, ABIF, and the ASEAN Insurance Integration Framework (AIIF) took the form of legally binding agreements which have undergone the domestic processes needed to make the said agreements binding under international law.

Grouping ABIF and AIIF with AFAS has important implications in relation to the form they took vis-à-vis the global trend of using soft law instruments for international financial regulation. To start with, the objectives of ABIF and AIIF are different from their global "counterparts" which are the Basel and the IAIS. While Basel and IAIS are primarily concerned with setting international standards for banking and insurance, respectively, the primary objective of ABIF and AIIF is to open the ASEAN member states' markets to each other. While the ABIF and AIIF also have a standard-setting component which is not covered by the AFAS protocols, the lack of progress in that area compared to market access shows where the importance lies in these sectors. Contrast this to the developments in the ACMF where the priority is the harmonization of rules. What can be the explanation for this divergence?

A. The dichotomy in the ASEAN Financial Integration Framework

The divergence between the two approaches under the AFIF is not a product of arbitrary decision-making. It is useful to first start with the premise that in the international sphere, countries set their own rules of interaction in order to make cooperation with other states possible. At their disposal is anything between a spectrum of legally binding obligations to non-binding commitments which serve as mere instruments of coordination. Deciding the form which this cooperation will take and its contents are subject to a lengthy process that does not always only involve the concerned government officials. Sometimes, domestic players like business and civil society groups, local politicians, and other domestic institutions (whether governmental or not) which have a stake in the matter get involved as well.

With respect to the AFIF, ASEAN has decided to combine both approaches within it to integrate the member states' financial markets. The AFAS, ABIF, and AIIF made use of legally binding agreements while the ACMF has made use of non-legally binding ones to satisfy their goals.

What can explain this dichotomy within a single framework? To answer this question, we need to dissect the agreements into two aspects: form and substance. The form aspect is simply concerned with the question of whether the agreement is legally binding or not and the considerations that were taken

⁷⁸ Although in varying degrees.

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in making this decision.⁷⁹ The substance of the agreement, on the other hand, can either refer to the contents of the agreement itself or the mechanisms used to enforce observance of the commitments. This is examined on the basis of its ability to influence the behavior of the state and make the latter engage in an activity which it would not have done in the absence of such an agreement.⁸⁰

Hard law instruments like treaties may be more stable and definite but their binding nature makes the adoption of measures more difficult. Part of the reason is it is subject to greater public and political scrutiny domestically since such agreements usually require an additional step of ratification, acceptance, or approval. Soft law instruments like MoUs, on the other hand, do not have any binding effect.⁸¹ Despite this, it could still be useful in making international commitments since it creates a reasonable expectation from other parties that a certain pattern of behavior will be observed from the time of the signing of the agreement.⁸² A caveat must be made here, however. Having a reasonable expectation might not necessarily be sufficient to compel states to allocate resources to effectuate the commitment.⁸³

All things being equal, international trade has greater distributive consequences than international financial regulation since opening market access to foreign players can result in the redistribution of wealth.⁸⁴ Resistance to commit may also come from the fear of losing the competitiveness of a domestic industry once integration pushes through.⁸⁵ Thus, for example, farmers from Thailand were wary of opening up Thai's economy due to their perceived inability to compete with possibly larger businesses from other member states.⁸⁶ This illustrates that there is an expectation that liberalization measures shall be unpopular, giving states an incentive not to comply. Treaties ensure that this will not happen by making non-compliance more costly.⁸⁷ As mentioned earlier, ASEAN has chosen to prioritize liberalization for banking and insurance sectors first which could explain why it has chosen to use treaties. However, this is not the complete picture.

Even before a treaty is adopted in ASEAN, we have to go back and consider how the member states manage their relationships. Though there is a call for a rules-based system, their preference for consultation and consensus-building must be remembered. Therefore, as ASEAN is going through a regime-change, one must presume that the cultural preference for a consensus underpins this whole process. In the negotiation of any agreement, the member states would have to reconcile this desire to reach a consensus to their policy preferences which are in turn influenced by their individual regulatory philosophies and the pressing national issues which they want to address. Finding common policies and ideologies between equal sovereign states should be hard enough but imagine that process between

⁷⁹ Raustiala, *supra* note 1.

⁸⁰ Raustiala, *supra* note 1.

⁸¹ There are different ways to classify the form of an international agreement. Raustiala (2005) refers to legally binding documents as "contracts" and non-legally binding ones as "pledges". In other articles on the subject, contracts may also refer to "hard law" and pledges as "soft law". For purposes of simplicity, we shall refer to legally binding agreements as "treaties" and non-legally binding agreements as "MoUs" in this paper. See Raustiala, *supra* note 1.

⁸² Andrew T. Guzman and Timothy L. Meyer, *International Soft Law* 2 J. LEGAL ANALYSIS 171, 174 (2010).

⁸³ Timothy Meyer, *Power, Exit Costs, and Renegotiation in International Law* 51 HARV. INT'L L. J. 379, 412 (2010).

⁸⁴ Chris Brummer, *Why Soft Law Dominates International Finance – And Not Trade* 13 J. INT'L ECON. L. 623, 625 (2010).

⁸⁵ Brummer, *supra* note 4.

⁸⁶ Yean and Das, *supra* note 63.

⁸⁷ Brummer, *supra* note 84.

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countries which are at different stages of development and regulatory and institutional maturity. With these considerations, it should not shock nor surprise anyone that the contents of ASEAN declarations and agreements are vague, ambiguous, and at best, hortatory. It might not be possible to reduce their minimum shared philosophy to something more specific than “economic cooperation.”⁸⁸

Take this already complicated process in the context of negotiating treaties specifically. There, a wider group of people would have to be involved in the decision-making. Apart from the government regulatory agencies or the so-called “technocrats”, politicians, industry groups, and the general public could participate and form part of the decision-making body that will decide if the treaty should be ratified by that country. The regulators may already have their own policy agenda but once these other groups become involved in the decision-making process, the former may have to consider other different (and sometimes conflicting) policy objectives as well.⁸⁹ How then, did ASEAN manage to enter into treaties with these seemingly insurmountable obstacles in place? The answer can be found in the details.

Part of the obligation entered into under the AFAS is to negotiate specific commitments which are set out in a schedule.⁹⁰ However, due to the flexibility given to the ASEAN member states to adopt liberalization measures only when they are ready, the protocols negotiated vary in depth⁹¹ per country. Some member states may not yet be ready to enter into negotiation rounds but are obliged to do so. As a result, you will have commitments which are watered down⁹² or need an additional action which is outside the purview of the negotiators in order to make them effective and enforceable. In an example cited by Inama and Sim (2015), Thailand has previously committed itself to allow companies in certain service sectors to have a foreign majority stake. However, it has yet to enact a domestic law which will turn this commitment into a reality.⁹³ A more extreme example would be that of the Philippines where an amendment of its Constitution is necessary in order to liberalize foreign ownership restrictions in certain sectors like public utilities,⁹⁴ mass media,⁹⁵ advertising,⁹⁶ and education⁹⁷ despite the commitments it might have made in its treaties with other ASEAN member states.

The ABIF utilized the same strategy. The 6th Protocol does not liberalize the ASEAN banking sector *per se*. Instead, it allows two or more member states to “conduct negotiations and agree to liberalize their banking sectors.”⁹⁸ The said protocol however does not mention what form the agreement between the

⁸⁸ *Supra*, note 17.

⁸⁹ Brummer, *supra* note 54, at 195.

⁹⁰ ASEAN Framework Agreement on Services 1995, art IV(1).

⁹¹ Raustiala, *supra* note 1.

⁹² Deunden Nikomborirak and Sherry M. Stephenson *Liberalization of Trade in Services: East Asia and the Western Hemisphere* (Paper presented for the Pacific Economic Cooperation Council (PECC) Trade Policy Forum on Regional Trading Arrangements, 2001) 6.

⁹³ STEFANO INAMA AND EDMUND W. SIM, *THE FOUNDATION OF THE ASEAN ECONOMIC COMMUNITY: AN INSTITUTIONAL AND LEGAL PROFILE* 48 (2015) at 127.

⁹⁴ Philippine Constitution, art XII(11).

⁹⁵ Philippine Constitution, art XVI(11).

⁹⁶ Philippine Constitution, art XVI(11).

⁹⁷ Philippine Constitution, art XIV(4).

⁹⁸ *Supra*, note 40.

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member states to liberalize their banking sectors should constitute. So far, the implementation of Section 5 of the 6th Protocol is usually executed through bilateral agreements in the form of a soft law agreement signed by the banking regulators of the participating member states.⁹⁹

What could explain the seemingly circuitous route? In an organization which has an affinity for issuing declarations and statements which have no legal value, a treaty can also signal credibility. Since it is a common perception within the region that ASEAN has not accomplished anything significant,¹⁰⁰ entering into legally binding obligations “signal...intentions with special intensity and gravity” and thus bolster the agreement’s credibility.¹⁰¹ Moreover, since the AFAS and ABIF had to be ratified in accordance with domestic procedures, legislative bodies, domestic interest groups, and other interested parties were given a chance to participate and provide inputs into the content of the agreement.¹⁰² This also reinforces public support for the initiative.

The AIIF does away with the need to execute a separate agreement to operationalize the liberalization. However, the cross-border liberalization in ASEAN is not yet complete since Indonesia and Myanmar both excluded themselves from this process. There is no indication given when the two countries will join the insurance liberalization movement.

Despite making “exit costs” more expensive for countries, treaties are not always an option because it is often harder to change their terms once approved.¹⁰³ In an industry which is subject to rapid external developments, the permanence of treaties might not be a good characteristic for regulators. ASEAN’s solution for this is the ASEAN-X formula since member states have the option of adopting the liberalizing measures if and only when they are ready. They are also allowed to catch up in the next round of negotiations if they do not meet the necessary parameters in the present round.¹⁰⁴ Furthermore, they are permitted to substitute the subsectors that were previously agreed upon to be liberalized to those outside the list.¹⁰⁵ However, once measures are adopted and ratified, there is no easy exit so this might still not be the most ideal solution.

Soft law instruments such as MoUs solve this problem by offering flexibility as terms can be easily adjustable and exit is made easier.¹⁰⁶ In a way, it allows the members of an organization with a diverse membership like the ASEAN to modify their commitments in line with their own individual

⁹⁹ Thus for example, the Bank Indonesia and the Financial Services Authority (OJK) and Bank Negara Malaysia (BNM) have signed a bilateral agreement in 31 December 2014 to implement the ABIF between them. BNM has also signed a similar agreement with the Bank of Thailand and the Philippine Central Bank (BSP) separately.

¹⁰⁰ S. Tiwari, *ASEAN’s Perception Problem in ASEAN MATTERS!: REFLECTING ON THE ASSOCIATION OF SOUTHEAST ASIAN NATIONS* 29 (Lee Yoong Yoong ed., 2011).

¹⁰¹ Raustiala, *supra* note 1, at 592; We ignore momentarily, for the sake of this line of argument, the weak enforcement mechanisms of the AFAS.

¹⁰² The degree to which domestic institutions within ASEAN contribute to the choice between a treaty and a non-binding agreement can be a topic for further research.

¹⁰³ Raustiala, *supra* note 1, at 591.

¹⁰⁴ Siow Yue Chia and Michael G. Plummer, *ASEAN Economic Cooperation and Integration: Progress, Challenges and Future Directions* (Cambridge University Press 2015) 106-107.

¹⁰⁵ *Id.*, 107.

¹⁰⁶ Raustiala, *supra* note 1, at 591-592.

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circumstances.¹⁰⁷ Moreover, since MoUs are not expected to undergo the lengthy and sometimes complicated internal process of ratification, negotiations are faster and can enter into force immediately.¹⁰⁸ For example, the three MoUs under the ACMF are now in effect and being implemented despite having only three (3) signatories so far.¹⁰⁹ These soft law instruments may also be the only workable alternative to an “anarchy”¹¹⁰ because it gives recalcitrant states the option to first adopt open-ended measures and thresh out the details in subsequent negotiations as the sentiment becomes more favorable.

Flexibility can also mean the openness of the agreement to a wide variety of parties. Treaties can only be entered into by member states. MoUs, on the other hand, can be signed by parties which have no international legal personality.¹¹¹ Hence, the MoUs under the ACMF can also be signed by a stock exchange located in a member state provided that it plays a substantial role in the review of qualitative listing requirements and it signs the said MoU together with its respective securities regulator, if the latter is not a signatory yet.¹¹²

The relative strength of domestic interest groups can also play a factor in the choice over form. According to Raustiala (2005), hard law instruments are preferred by such groups since they are given an opportunity to play a role in the decision-making process.¹¹³ If they are weak, especially in areas of technocratic cooperation such as securities regulation, the tendency is for the state to negotiate soft law instruments instead.¹¹⁴ In so far as the ACMF's case is concerned, sentiment regarding the project appears to be mixed among domestic industry groups in different countries. There are groups complaining the ASEAN leaders are slow and have not done enough¹¹⁵ and there are some who are skeptical about the gains to be had from the project.¹¹⁶

¹⁰⁷ Guzman, *supra* note 14, at 591.

¹⁰⁸ Raustiala, *supra* note 1, at 592.

¹⁰⁹ These MOUs are the following: Memorandum of Understanding (MoU) for the ASEAN Collective Investments Scheme (CIS) Framework; MoU for the Streamlined Review Framework for the ASEAN Common Prospectus; and MOU for the Expedited Review Framework for Secondary Listings.

¹¹⁰ Christine Chinkin, *Normative Development in the International Legal System in COMMITMENT AND COMPLIANCE: THE ROLE OF NON-BINDING NORMS IN THE INTERNATIONAL LEGAL SYSTEM* 21, 41 (Dinah Shelton ed., 2000).

¹¹¹ According to Crawford (2012), “a subject of international law is an entity possessing international rights and obligations and having the capacity to (a) maintain its rights by bringing international claims; and (b) to be responsible for its breaches of obligation by being subjected to such claims.” States pre-eminently have these capacities. (James Crawford, *Brownlie's Principles of Public International Law 8th Edition* (OUP 2012) 115).

¹¹² SEC News Release, ‘Malaysia, Singapore and Thailand to implement a streamlined review framework for applications to offer or list securities in ASEAN’ (SEC Thailand, 5 March 2015) <http://www.sec.or.th/en/Pages/News/Detail_News.aspx?tg=NEWS&lg=en&news_no=25&news_yy=2015> accessed 23 February 2016.

¹¹³ Raustiala *supra* note 1, at 598.

¹¹⁴ Raustiala *supra* note 1, at 600.

¹¹⁵ Hardasmalani, *supra*, note 16.

¹¹⁶ In a study conducted for the United States Agency for International Development (USAID), it was found that:

“Almost all market participants agree that the benefits of ASEAN capital market integration will not be enjoyed equally among ASEAN members and that Singapore will probably benefit the most. It is has the most advanced financial industry. Some participants believe that Indonesia should take the opportunity to internationalize Indonesian companies through cross-listings in other ASEAN capital markets.” UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT, IMPACT OF ASEAN CAPITAL MARKET INTEGRATION ON INDONESIA'S CAPITAL MARKET AND ECONOMY 54 (Jan. 2013) http://pdf.usaid.gov/pdf_docs/PBAAA120.pdf.

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With respect to the subject-matter of the MoUs in the ACMF, one would notice that they all pertain to setting up new standards that member states may choose to adopt. It must be noted that the said standards do not replace the existing domestic ones currently enforced within the respective jurisdictions but are, instead, meant to be applied only to issuers who want to do cross-border issuances.¹¹⁷ The regulatory requirements currently in force within a particular jurisdiction can still apply to such issuances should the regulator choose to do so. In other words, the MoUs serve as the “focal point for cooperation”¹¹⁸ for the member states who want to make cross-border transactions easier and more efficient. The coercive mechanisms in a treaty will not be necessary as defection will be less possible in an instrument which merely serves as a guideline for interaction and where the commitments made within remain discretionary.¹¹⁹ For example, a prospective issuer who is planning to offer ASEAN Securities¹²⁰ will still have to apply and obtain approval from both the Host and Home Authorities for the cross-border offering of ASEAN Securities. Such process is still entirely within the discretion of such authorities.¹²¹ However, defection is still possible in treaty instruments if their contents are vague and ambiguous, when, for example, the commitments made still need further negotiations and cannot be operationalized on its own.¹²²

However, using this approach can also be problematic, at least judging from the response by the member states to the MoUs prepared under the auspices of the ACMF. Since the MoUs can be considered as independent and one-off agreements, trade-offs could not be made between one agreement to another in order to facilitate cooperation and agreement among the member states.¹²³ Moreover, intergovernmental cooperation is only possible when the individual objectives of each member are so related that each is seen to be supporting or facilitating the realization of the other.¹²⁴ In a grouping where the members are in different levels of development and hence, have different objectives, matching these might be more difficult. There may be inherent incongruity of objectives in this scenario.

B. Has ASEAN managed to comply with its objective of adhering to rules-based regime?

The discussion in the previous section makes the argument that the treaty approach is not a one-size-fits-all model and might not be the best approach to take in facilitating cooperation between states

¹¹⁷ The result would be the creation of two regulatory universes out of which an opportunity may arise for regulatory arbitrage. It is without a doubt that the standards promulgated under the ACMF MoUs for cross-border transactions are more “relaxed” than the domestic standards that have to be observed by entities wishing to raise capital domestically. As a result, there might be an incentive to raise capital across borders over domestically. This can be the subject of a further study. Another aspect of this that is worth looking into is the risks (including systematic risks) that may arise as a result of the increased cross-border transactions without a centralized monitoring/regulatory body.

¹¹⁸ Guzman and Meyer, *supra* note 82, at 176.

¹¹⁹ Guzman and Meyer, *supra* note 82, at 192.

¹²⁰ As defined under the Handbook for Issuers making cross-border offers using the ASEAN Disclosure Standards under the Streamlined Review Framework for the ASEAN Common Prospectus, available at <http://www.mas.gov.sg/~media/resource/legislation_guidelines/securities_futures/sub_legislation/Streamlined%20Prospectus%20Review_Handbook.pdf>.

¹²¹ Karmel and Kelly, *supra* note 75, at 946.

¹²² Brummer, *supra* note 4, at 271.

¹²³ Pierre-Hugues Verdier, ‘Transnational Regulatory Networks and Their Limits’ (2009) 34 YJIL 113, 129

¹²⁴ *Id.*

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in certain instances. What does this imply for ASEAN's attempt to shift to a rules-based organization? Related to this is the question of whether being a "rules-based organization" means the total transformation into an organization which is governed by hard law instruments. The AEC blueprint does not say so nor is it recommended by this paper.

The use of informal networks such as the ACMF cannot be entirely done away with due to the role it plays in creating channels of communication and helping the less developed member states build their capacity.¹²⁵ It is also highly possible that the MoUs will serve as precedents to a legally binding document as it first builds consensus among the member states.¹²⁶ The ASEAN way is a good thing in this sense as it gives all member states the opportunity to have ownership of the measures they adopted and thus help in its implementation.¹²⁷ Even the flow of information within ASEAN through constant consultation and communication might affect the incentives of the non-compliant states towards eventual compliance.¹²⁸

As a conclusion therefore, ASEAN's rules-based regime (for now) will have to be composed of both hard law and soft law instruments since it provides the most adequate response to AFIF's objectives to integrate through liberalization and harmonization. Such regime is also able to accommodate the region's members which are at different stages of development by first allowing those who are capable and ready to implement the proposed measure to go ahead. This was perceived to be better rather than waiting for every country to be in substantially the same place first before moving forward with the initiatives as there is no certainty when that is going to happen. However, the unintended consequence of this innovation is the weakening of the treaty structure since legally binding obligations will only become so if and when the parties do decide to activate it despite the acceptance or ratification of the main treaty. Thus, the low costs of entering into a treaty in ASEAN help explain why member states sometimes choose it over soft law instruments. But in the end, this distinction does not matter. With the significant amount of discretion given to the member states even under the treaty approach, the line separating treaties and MoUs in ASEAN has been blurred, at least functionally because the compliance costs in both agreements are virtually the same. Since the implementation and compliance of agreements, irrespective of whether they are legally binding or not, are preconditioned upon the self-assessed readiness of the member state, it matters little whether the measures that have been adopted are contained in a treaty or not.¹²⁹ The ASEAN minus X formula or 2+x approach underpinning all agreements adopted by member states induce them to adopt treaties because the sovereignty costs even for these types of agreements are low while the benefits of joining (such as contribution to group solidarity or insulation from criticism) are high.¹³⁰

For Brummer, (2011) this distinction might not be important at the end of the day. The legality of an agreement does not necessarily have to be equated with its formal status, i.e., whether it is in a treaty form or some other legally binding instrument under the Vienna Convention on the Law of Treaties. In

¹²⁵ Slaughter, *supra* note 6, at 293.

¹²⁶ Weiss, *supra* note 50, at 554.

¹²⁷ Slaughter, *supra* note 6, at 305

¹²⁸ *Id.*, at 307.

¹²⁹ Meyer, *supra* note 83, at 395. He presents a completely opposite argument on this. He opines that the "doctrinal distinctions between legally binding agreements are functional signals about the future likelihood of compliance. From a compliance perspective, then, the chief difference between hard law and soft law agreements is the likelihood of future compliance signaled by the designation."

¹³⁰ *Id.*, at 415.

some instances, it might be better to look at measures promulgated to support the original mandate and their scope.¹³¹ More importantly, the coercive pull of an instrument or its ability to bind states into compliance is not anchored on the obligations it contains or the form it has taken. What could be more important in ensuring compliance and preventing defection is the mechanisms that enforce compliance.¹³² Unfortunately, the question of whether ASEAN has sufficient mechanisms to enforce compliance whether in general or with respect to AFIF is not covered by this paper. However, it could be an interesting topic for future research.

IV. CONCLUSION

The Association of Southeast Asian Nations (ASEAN) traces its roots to a necessity to safeguard security and stability within the region amidst a decade of turbulence and volatility. Developments, both internal and external, have taken it to a whole new direction after almost fifty years of existence: concerns about security remain but talks of financial integration have now taken over the region's consciousness and have culminated in the adoption of the ASEAN Financial Integration Framework (AFIF). Almost fifty (50) years in since ASEAN was first established, it is now almost unbelievable that there was a time when even the negotiations for the lifting of tariffs on snow ploughs in a mostly tropical region like Southeast Asia almost reached an impasse!

Despite these obstacles, ASEAN has managed to devise new processes and mechanisms which made economic cooperation possible between member states of varying levels of development. What started out as an informal organization which relied on diplomacy rather than law and consensus-building through informal mechanisms has gradually evolved into a formal organization in the midst of transitioning into a rules-based regime.

The frustrations engendered by the slow pace of reforms in order to bring into fruition an integrated ASEAN financial market is well taken. However, it should also be realized that given the history of how ASEAN started out, what ASEAN has achieved so far can already be considered great progress, no matter how insignificant it is in the grand scale of things. As stated by De Guzman (2005), "it is possible that such [weak] agreements represent the highest value form of cooperation from the States involved and should therefore be pursued."¹³³ It must be remembered that ASEAN is and remains an inter-governmental organization which observes a unique culture we now call the "ASEAN Way." Because of this organizational culture, whatever initiatives that pass under the strict scrutiny of the member states are sure to stay.

¹³¹ Brummer, *supra* note 4, at 306.

¹³² Brummer, *supra* note 54.

¹³³ Guzman, *supra* note 14, at 611.