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Session II

The Unfinished Business of Strengthening the Domestic Financial Systems:
How Much Unfinished and How to Help Finish

**International Cooperation
for Domestic Financial Reform:
A Peer Review Model for APEC/PECC?**

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"International Cooperation for Domestic Financial Reform:

A Peer Review Model for APEC/PECC?"

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Introduction

Thank you, Soogil, and the PECC Finance Forum, for inviting me to Santiago for this interesting conference and allowing me to share with you the "Peer Review" experience in the OECD. As I understand that Chile holds the Chair of APEC this year, I hope that my remarks will be helpful in your future deliberations about possibly implementing such an exercise in the APEC region, particularly with regard to the role of international cooperation in bringing domestic financial reform forward.

When speaking of domestic financial reform, the concept of "international cooperation" as a key component of the process may seem somewhat unusual to those not fully familiar with this concept. Interestingly enough, however, we in the OECD have spent almost half a century using this "peer review" process to promote and support a broad range of reforms, be they for domestic or international purposes. In meeting the task to make my presentation, I hope that you will feel more comfortable with this concept or process by the time we conclude our discussions.

Let me first give you an outline of my remarks today:

- i) First, I will identify some of the current issues for domestic financial reform in the APEC/PECC economies; then
- ii) I would like to draw your attention to the "values" and "characteristics" of the "Peer Review" process in the OECD; and
- iii) high-light some examples of OECD/DAFE experience with "peer review".
- iv) I will conclude with some personal opinions on the implications/applicability for APEC/PECC, especially in the financial area.

¹ I am very grateful to my colleague, Yosuke Kawakami, Principal Administrator, for his great assistance in drafting these remarks, as well to the other OECD staff members for their contributions. But the responsibility for these remarks is mine. The views expressed in no way commit the OECD or its Member countries.

² The 30 OECD Members are the following: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Norway, New Zealand, Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

While there is no need to explain to you in detail the current issues for domestic financial reform in the APEC/PECC economies, I would first just like to make sure that we have a common understanding of the major topics that should be addressed in this context.

From our viewpoint, the most urgent issues for domestic financial reform in the APEC/PECC economies are the following:

1) Strengthening the safety and soundness of the banking system

This includes, inter alia, the disposal of bad loans/assets from the banking system, a task most APEC economies affected by the recent financial crises have already embarked upon, but may not have quite completed.

2) Developing and improving the functioning of capital markets, especially bond markets

We welcome the Asian Bond Market Initiative establishing the right framework conditions for the blossoming of sound and efficient bond markets, and look forward to the discussion on these subjects in Session III tomorrow morning.

3) Enhancing corporate governance

This is a subject to which we at the OECD attach great much importance, since it is a topic on which we have taken leadership in international discussions, beginning with the establishment of the OECD Principles of Corporate Governance in 1999, and culminating this April with their revision and expansion .

4) Establishing/strengthening pension systems

This issue is of utmost urgency to the group of “ageing” economies that includes most of the OECD membership. We have thus been extensively researching and analyzing various pension systems, both public and private, in order to distill best practices both within the OECD area and outside it. Indeed, this issue has been, for the last several years, one of the issues on which the OECD has most focused, including in our latest Ministerial held last month.

We have in the OECD a specialized Working Party that deals with Private Pensions, and we will be helping with the establishment in July of the International Organization of Pensions Supervisors (IOPS), so that private pension authorities on a global scale can benefit by sharing their positive as well as negative experiences. This is an example of what the OECD is best equipped to do: learning from each other.

5) Fostering the channeling of domestic savings to the domestic financial system

In a sense, this issue is related to all of the above-mentioned subjects and is of particular importance for most of the Asian economies represented in APEC, as they are endowed with excess domestic savings. I understand, in this connection, that the Asian Bond Market Initiative was launched precisely as one of the measures to address this issue.

6) Capacity-building

Last but not least, it is important to keep this issue in our minds, since it applies not only to market participants, but also, and perhaps more importantly, to regulatory and supervisory institutions and the legal system as well.

My organization is deeply interested and involved in all of the above issues. In addition to our work with our member countries, the OECD carries out an extensive program of financial sector activities in cooperation with non-OECD countries. The annual meetings of the "Tokyo Roundtable on Capital Market Reform in Asia" are good examples of these. Again, in the best spirit of the OECD, in these activities, we bring together regulators, academics and market participants, so that capacity-building is fostered at all levels through in-depth and hands-on discussions.

"Values" and "characteristics" of the "Peer Review" process in the OECD

I would now like to turn to the focus of my presentation, describing the "values" and "characteristics" of the "Peer Review" system/process, as it has been developed and practiced in our Organization. The system is strongly supported by our Members who often cite it as one of the unique and defining characteristics and comparative advantages of the OECD.

I should first mention that when Soogil first approached me with the idea of presenting this paper, the proposed title of my presentation placed special emphasis on the "peer pressure" aspect of the process. In fact, while one of the key components of the effectiveness of the "peer review" process lies indeed in this very aspect, I must emphasize that when the objective of any exercise is the encouragement of reforms, the process can and should be one that is friendly and constructive, based on exchanging positive and negative experiences. It should not be of a confrontational or even of a negotiating nature – and our experience at the OECD goes clearly in this direction.

A “peer review process” to encourage reforms should, therefore, be differentiated from one in which the objective is to see if certain international obligations or commitments are being met, or to determine if international standards designed to combat illegal or harmful activity are being applied. A rare and exceptional example in our context would be the OECD Anti-bribery Convention (involving binding international commitments), which I will describe later in my presentation.

The concepts of “peer review” and “peer pressure”, and their relationship

While the “peer review” mechanism has been used extensively over the past half century in the OECD and other international fora, the term does not appear to be rigorously defined in the discipline of international relations, economic or otherwise. However, over the years, the expression seems to have assumed a specific meaning in the practice of international organizations. To quote from one of the OECD’s recent publications on “Peer Review”:

“Peer review can be described as the systematic examination and assessment of the performance of a State by other States, with the ultimate goal of helping the reviewed State improve its policy making, adopt best practices, and comply with established standards and principles. The examination is conducted on a non-adversarial basis, and it relies heavily on mutual trust among the States involved in the review, as well as their shared confidence in the process. When peer review is undertaken in the framework of an international organization – as is usually the case – the Secretariat of the organization also plays an important role in supporting and stimulating the process. With these elements in place, peer review tends to create, through this reciprocal evaluation process, a system of mutual accountability.” *1 (emphasis added)

Clearly, “peer review” should be distinguished from the importantly related but somewhat different concept of “peer pressure”, which can be characterized as the “influence and persuasion influenced by the peers during the process” *1. The term “peer pressure” appears to have been first used in other social science disciplines, particularly in pedagogy and behavioral studies, and, as mentioned before, is a key element that contributes to the efficacy of the entire process. To quote again from the same publication:

“The peer review process can give rise to peer pressure through, for example:

- i) a mix of formal recommendations and informal dialogue by the peer countries;
- ii) public scrutiny, comparisons, and, in some cases, even ranking among countries; and
- iii) the impact of all of the above on domestic public opinion, national administrations and policy makers.

The impact will be greatest when the outcome of the peer review is made available to the public, as is usually the case at the OECD. ... Public scrutiny often arises from media involvement.”³

It is important to keep in mind that peer pressure does not take the form of legally binding acts, sanctions or other enforcement mechanisms. Instead, it is a means of soft persuasion which can become an important driving force to stimulate countries to change, achieve goals and meet standards.

The values and the characteristics of “peer review”

Let us now take a look at some of the values and the characteristics of a typical peer review exercise.

- First of all, the exercise is a “discussion among equals”. It is a “two-way, open, frank and constructive dialogue”, as opposed to a “one-way lecture”, or a “hearing by a superior body” that would hand down a binding judgment or punishment
- Second, it is an information and experience-sharing process where the key is of mutual learning. The translation and adaptation of foreign experiences can be useful for domestic purposes, and is, moreover, an important capacity-building instrument.
- Third, while the process is “collegial, friendly and informal”, the end-result is “transparent”. Although the discussions themselves are informal and confidential, this nature allows everything to be discussed, sometimes leading to very heated but nonetheless gentlemanly debates on key domestic as well as international policy issues. Moreover, the final product is usually made open to the public for everyone to see and comment upon and/or criticize, if necessary.
- Fourth, the “soft law” (i.e. non legally-binding) nature of the process is particularly suited for encouraging and enhancing compliance in situations where traditional enforcement mechanisms (“hard law”) may, on occasion, have the unintended and opposite effect of only breeding animosity.
- Fifth, while a typical OECD peer review is conducted at OECD headquarters with “lead examiners”, the modality in principle offers the flexibility of being conducted also on-site (i.e. in the country being examined); moreover, the “examiners” can consist of the Permanent Delegations to the OECD and/or representatives from respective capitals and can even be conducted without “lead examiners”.

³ Peer Review: An OECD Tool for Co-operation and Change, OECD, 2003

OECD/DAF experience with the “peer review” exercise

Let me turn now to some OECD experiences regarding “peer review” and highlight some recent and on-going examples/case studies in our Directorate.

a) EDRC (Economic Development and Review Committee)

Perhaps one of the best known of the OECD’s peer reviews is the Economic Development and Review Committee (EDRC), which started as ways for members to learn from each other’s experience, and now meets regularly to assess every member’s economic performance in relation to broad economic guidelines. These are multi-disciplinary assessments involving the various parts of the OECD Secretariat, depending on the policy areas that are being given the greatest attention. The results are publicized in the OECD *Economic Surveys* of individual economies; I might also add that some of your countries are already subject to these reviews.

b) Accession of new members

Accession of a new member to the Organization, generally speaking, is always a good opportunity for peer review, although strictly speaking the prospective new member is not yet a “peer”. In this connection, I do remember – as I am sure Soogil also recalls - that we had some lively discussions with the Korean authorities in their accession talks, especially as regards adherence to the OECD Liberalization Codes. There is a long tradition of using peer reviews to implement these Codes. Evidence of the success of this approach can be found in the almost complete liberalization of capital movements among OECD countries today.

c) Public debt management and bond market development

The OECD’s Working Party on Public Debt Management, a rather senior level forum, carries out in effect a peer review process in its meetings. This forum has been very successful in developing best practices for debt management and development of government securities markets. Indeed, these best practices are also a focal point of our meetings with non-member countries that I mentioned earlier. I believe my colleague Yosuke will further elaborate on these topics, during Session III on bond markets tomorrow morning.

d) Competition

We have concluded and published more than 20 peer reviews of competition laws, policies, and most importantly their implementation, both of members as well as non-members (e.g. Chile, Russia and South Africa). The latest one published concerns our review completed with Mexico in February this year. During the review, for example, the examiners’ report called attention to how judicial proceedings affected the ability of

regulatory officials in Mexico to implement their policies. The peer review discussion provided a forum to discuss these shared problems with other officials ("peers") and learn from the experiences of others.

e) Investment

Last year, we published the investment policy review of China: "OECD Investment Policy Reviews – China - Progress and Reform Challenges". While this was not, strictly speaking, a "peer review" in and of itself, it might nevertheless still be considered a case study of the process extended to non-members. The publication culminated a multi-disciplinary, multi-year, and wide-ranging cooperation program with the Chinese Ministry of Commerce that reviewed various issues and policies related to FDI in China, which, as we all know, has been and will continue to remain, for the time being, the main "engine" for rapid growth there. A key aspect of this program was the exchange of experiences between Chinese and OECD member investment policy officials.

f) Corporate Governance

As I mentioned earlier, we have just completed a major revision of the OECD Corporate Governance Principles. We are now engaging in dialogue with governments that are seeking reviews to assist them with their respective domestic reform efforts. In this connection, the Asian and Latin American Roundtables on Corporate Governance that we have been organizing can be seen as a form of peer activity, which is now being extended to enforcement issues. One precondition for peer reviews is a firm understanding of how systems/economies function, and a shared understanding about how to view the policy issues. In the area of corporate governance, our regional Roundtables have permitted us to make important advances in this respect.

g) Anti-bribery

Anti-bribery or combating corruption is another area where the OECD has extensive experience with the peer review process, which in this case, has been incorporated in an internationally legally binding instrument, the "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions".

However, I must emphasize once again that this represents the rare and exceptional case of a "hard-law" process where the activities concern monitoring compliance with an international obligation. In contrast, the "Anti-Corruption Action Plan for Asia-Pacific" is a good example of a voluntary, "soft law" approach. Needless to say, we believe that the latter model is more suitable for the APEC/PECC environment.

Implications/applicability for APEC/PECC, especially in financial sector development

Let us now turn to the implications and applicability of the peer review process for APEC/PECC, especially with regard to financial sector development. Thus far, I have described the peer review context from the OECD's perspective. While this mechanism is a working method most closely associated with our organization, several other intergovernmental organizations, programs and fora utilize this technique as well, albeit in different contexts and modalities.

These include:

- The G7 Finance Ministers' process could be thought of as a "peer review" process (one could add the G10, the Financial Stability Forum, and the G20);
- The IMF Country Surveillance mechanism, with which many of you are familiar, also has some aspects in common with peer review;
- Peer Review has also been developed within the WTO under the Trade Policy Review Mechanism;
- In the EU framework, peer review is used in several areas, such as labor market policies;
- Within UN bodies, States use peer review to monitor and assess national policies in such areas as investment.

With the above international as well as our practices in mind, I would argue that, generally speaking, the peer review process would be well suited for the current APEC/PECC environment that emphasizes, as I understand it, consensus and "soft laws". Moreover, APEC already has the basic "surveillance" mechanism in place, with regular meetings on the various disciplines covered by the umbrella framework. While the speed of integration does differ among sectors, current and established "common goals" in the respective sectors, as well as those agreed in the future, and aspirations for their achievement by a certain agreed date, are definitely good building blocks for future peer review exercises in the respective disciplines.

This being said, I must, as economists always do, add several qualifications or caveats:

- One striking aspect of the economies in the APEC region is their great diversity. For our peer review exercises, we in the OECD rely on the relatively homogeneous nature of our membership, to some extent with respect to the relatively advanced stage of development of their economies but even more so with respect to their commitment to pursuing open and market-oriented policies. An essential element is the high degree of trust shared among the member countries. The heterogeneity that does exist within the generally homogeneous

membership is useful for OECD peer reviews, in that many countries have experience that is useful to pass to others.

- It is essential to note that the overall nature of the respective memberships differs significantly. In this respect, actual and effective implementation of peer review within APEC could be more difficult. --- Although we have not had a particular problem with this issue in the Asian and Latin American Roundtables on Corporate Governance (where indeed we found remarkable consensus), it is probably too simplistic to assume a smooth application/implementation across all segments of the financial sector, where the divergence is more pronounced relative to other sectors of the economy.
- Another future issue is the feasibility of the exercise without a neutral, well-staffed and specialized Secretariat. Although I understand that APEC now has a Secretariat, I believe it is relatively small. Country reviews are rather resource intensive. We at the OECD are fortunate to have a very dedicated and specialized but also multi-disciplinary Secretariat to conduct expert and unbiased analyses. While I recognize the existence of well-staffed think-tanks and research organizations in the APEC region as well as international organizations that are more than competent for this purpose, the selection of such a neutral Secretariat will be one of the key decisions you will be making should you proceed further along this avenue.

Nevertheless, with your energy, dynamism, and dedication, I can confidently project that, if the APEC/PECC economies do politically and collectively decide to pursue such a path in the future, you will have in time an effective “peer review” framework that compares best practices/ experiences in financial reform in the Asia-Pacific, for both domestic and international purposes.

And may I assure you that the OECD in general, and my Directorate in particular, will be most happy to assist and cooperate in every way possible during the interim period, in order to achieve this ultimate goal!

Thank you very much for your attention, and I will be happy to take your questions during the discussion.

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