Establishing an integrated payment system (real-time gross settlement) in ASEAN
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ESTABLISHING AN INTEGRATED PAYMENT SYSTEM (REAL-TIME GROSS SETTLEMENT) IN ASEAN
A Proposal for a Cross-Border Mechanism to Support the AEC 2015
INTRODUCTION

1. Background Issue

GLOBALIZATION: one of the most popular words in the last two decades. Everyone knows the word globalization on television, radio, from friends and any media. Some people think that it is the global world influence; others think that it is a disclosure of internal nation to the outside world. Many countries in every region in the last three decades try to integrate their economy, culture and society among each other. By the definition of Bhagwati,¹ the economic globalization means the integration of national economies into international economies through trade, FDI, capital flows, migration, the spread of technology and military presence. Europe has been united since 1958, by the Treaty of Rome, which created the European Economic Community (the EEC), or called ‘Common Market’. In the Asian region, the Association of South East Asian Nations (ASEAN), which was established in 1967², is now trying to be one of the most considerable economic regions in the world. A more detailed description of these two regions can be found in Chapter II and III.

Globalization itself has different meanings. The ESCW of UN³, in its annual review stated as follows:

"Globalization is a widely-used term that can be defined in a number of different ways. When used in an economic context, it refers to the reduction and removal of barriers between national borders in order to facilitate the flow of goods, capital, services and labour... although considerable barriers remain to the flow of labour... Globalization is not a new phenomenon. It began towards the end of the nineteenth century, but it slowed down during the period from the start of the First World War until the third quarter of the twentieth century. This slowdown can be attributed to the inward-looking policies pursued by a number of countries in order to protect their respective industries... however, the pace of globalization picked up rapidly during the fourth quarter of the twentieth century..."

So, in this case, the term “globalization” has not always had a positive connotation, it has also had a negative one. Accomplishing something through globalization will not always

²ASEAN is an intergovernmental organization established on August 8, 1967 in Bangkok (Bangkok Declaration) by the five founding fathers Member Countries, namely, Indonesia, Malaysia, Singapore, Philippines, and Thailand. Then Brunei Darussalam joined on January 8, 1984 and the followed by Vietnam on July 28, 1995, Lao PDR and Myanmar on July 23, 1997 and lastly was Cambodia on April 30, 1999 and now called ASEAN+5 or ten member states of ASEAN. Available at http://www.asean.org/asean/about-asean/overview, last accessed on January 9, 2015.
be smooth; it will have its obstacles and challenges. The main dilemma is typically the frequently unfair distribution of the benefits of globalization between parties, and this phenomenon is a challenge to be considered by members in the regions.

With regard to this, Hveem divided the regional phenomenon in the era of globalization into three generations, as follows:

1. "The first generation is from the end of World War II, which the projects was to achieve the goals of security and political stability.
2. The second-generation episode started with decolonization in the 1960s and faded out early in the 1970s.
3. The advance of globalization process after the end of the Cold War."

Another scholar, Takis Fotopoulos, argues that globalization refers to the case of a borderless global economy in which economic nationalism has been eradicated and production itself has been internationalized in the sense that the big corporations have become stateless bodies involved in an integrated internal division of labour which spans many countries. Moreover, Acharya utters that global democratization has had several implications on the regional development:

1. It alters the political climate on which regional interactions are based;
2. It calls into question the legitimacy of existing regional norms and the relevance of existing institutional mechanisms;
3. The transition to democracy allows for newly installed governments to adopt bold foreign policy leading to better cooperation and conflict management;
4. It creates more domestic transparency that regional integration needs;
5. It creates a deeper basis for regional socialization by according space to civil society and accommodating its concerns;

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4 The effect of globalization is not always more connected or integrated but also less connected or disintegrated, like the crisis in 1997 in Asia and in 2007 in Europe.
6 Liberalizing international economic transactions (within the Western world) would be done (only) along with social stabilization and state-building.
7 The second generation is building the Westphalian state system and it was to serve economic growth; as well as security motives in their assistance to achieving state-building goals.
8 It is not only they have given more weight to regional power but they have also reordered the relative salience of economic growth and sociopolitical stabilization goals, but with different effects on different parts of the world. They may also have put Westphalia behind them.
6. *It broadens the scope of agenda for regional institutionalization; and finally, democratisation may secure greater support for regional integration and cooperative projects with outside powers.*”

Furthermore, Tom G. Palmer defines globalization as the diminution or elimination of state-enforced restrictions on exchanges a cross-borders and the increasingly integrated and complex global system of production and exchange that has emerged as a result.¹¹ One important thing that should be considered is that economic globalization is not independent, it is interdependent with culture and politics. Even though the separation is obvious, the political globalization is a necessary complement to economic globalization, whereas social and cultural globalizations are the inevitable effects of economic globalization.¹² In this regard, the author concludes that the impact of political globalization is one of the most influential factors for the economic globalization of any region compared to social culture globalization.

ASEAN countries have political, economical, social and cultural differences amongst its members. With regard to the globalization, according to KOF Globalization Index¹³, most of the ASEAN members are least globalized. The ASEAN countries categorized as most globalized are Singapore and Malaysia (ranked at no. 5 and 24), and the least globalized members are Brunei (55), Thailand (57), followed by Philippines (83), Indonesia (91), Cambodia (118), Vietnam (124), Myanmar (178), and Lao PDR (187).

No country can avoid globalization. China (72), for example, which is known as a solitary country, is also impacted by globalization and has now become more open to the outside world. Zha Peixin stated that China has learnt from her long history that isolation leads to backwardness.¹⁴ It means that the Great China reformed its political policy to be open-minded. These days, countries from all over the world try to embrace the opportunities of globalization and undergo reformation to adapt to a changing world.

The historical roots of globalization are undetermined. Some people think it was from a very long time ago, but scholars placed the beginning of globalization in the modern age. Globalization began around the 19th century, when industrialization arose. In this era of imperialism, European countries became one of the first global economic powers. They had superior manufacturing and technology, such as steel and coal. On the other hand, globalization also impacts negatively and is one of the factors creating the need for war to conquer other countries to integrate into their economic region. During World War II the global economy broke down into a global war. Nazi Germany in Europe and Imperial Japan

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¹¹Tom G Palmer, "Globalization is Great!", *Cato Institute Vol. 1 no. 2*, 2002.
¹²Fotopoulos, *Op cit*.
in Asia endeavoured their own fascist manners of regional economic integration in the form of the New Order and the Greater East Asia Co-Prosperity Sphere.  

During the great depression of the 1930s, countries became the agents of economic revival and the defenders of domestic welfare and employment against disturbances from the outside worlds. This is one of the conditions that prompted the leaders of European countries to design or create a common market among its member through the eradication of trade barriers and the setting up of a common external trade policy. The European leaders politically created the EEC by the Treaty of Rome (the EEC Treaty) in 1957. The EEC governance required political collaboration along with its members through official supranational cooperation. A more detailed elaboration on supranational institution will be explained in the specific chapter.

After World War II, the eastern region countries did the same as the countries in the west who aligned themselves with neighbouring countries in the region. According to Laurence Henry, regionalism is a process of drawing together states in the same geographic region or sub-region, most often within a regional international organization. The state members within the region are joined to solve their common problem and pass them onto the association or international organization that they built with specific functions.

Matt Rosenberg divides the 196 countries of the world into eight regions, and one of the biggest regions is Europe with 48 countries. The European founding countries, which started the European Economic Community (EEC) in 1958 by Treaty of Rome, were Belgium, France, Italy, Luxembourg, the Netherlands and West Germany. Denmark, Ireland and the United Kingdom joined in 1973, followed by Greece in 1981 and Portugal and Spain in 1986. In 1992, it then became the European Union (EU) by the Maastricht Treaty (TEC). Later, other European countries joined this union. The author concludes that the EU used treaties to create a project.

Like in their European counterparts, countries in the Southeast Asian region established ASEAN in 1967, and also started their aspiration to consolidate by making a

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18See further sub chapter on Supranational vs. Intergovernmental Institution.
22Ibid.
cooperation in the economic, social, cultural and political fields amongst its members since 1976 (the ASEAN Concord). After several meetings, at the 12th Summit in January 2007, the ASEAN leaders declared their commitment to the creation of the ASEAN Economic Community (AEC) by 2015 and to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital. The AEC will transform ASEAN into a single market and production base by: i) accelerating regional integration in the priority sectors, ii) facilitating movement of business personnel, skilled labour and talents, and iii) strengthening the institutional mechanisms of ASEAN. The author shares the idea that one of the important roles in facilitating free movement of goods and services is the utilization of existing payment systems by integrating all members.

With respect to the benefits of creating a regional integration in ASEAN, Richard Stubbs argues that there are three reasons for this growing sense of an Asia-Pacific regionalism. These are as follows:23

“(1) Foreign Direct Investment (FDI) and trade have become increasingly regionalized;
(2) The advent of the North American Free Trade Agreement (NAFTA), which set the stage for a North American economic region, and the Single European Act (SEA) and the Maastricht Treaty, which created the Single European Market and European Union (EU), forced the Asia-Pacific region to think of itself as a region in contradistinction to North America and Europe; and
(3) Neo-liberalism association with globalization and the resulting collapse of time and space in international economic transactions challenge many of the values and practices that are to be found throughout the Asia-Pacific region.”

Consequently, the author is focusing in this research on the influence of cross-border transactions known as cross-border payment system in the region in order to support the objectives of the AEC. Globalization prompts people to want to fulfil their needs with goods from outside of their countries. Neighbouring states fulfil their needs of goods and services by exchanging products and services among its region. The movement of exchanged products and services needs to be effective and efficient, using an instrument, which could fulfil everyone’s wishes. An integrated payment system supports their needs to facilitate exchange in the region.

2. Research Questions

In creating an integrated payment system for the member countries of ASEAN, a legal foundation is needed to provide legal certainty in order to make the system effective and efficient. It also needs a mechanism to solve problems when a dispute arises due to different laws. Therefore, this research will focus on the following questions: (1) how to provide a

sound legal basis for a cross-border payment system within the ASEAN region countries. The
next question is (2) how to resolve a dispute due to conflict of law. For these two questions,
the author will analyse particularly from the “applicable law” and “applicable forum in the
event of dispute settlement”. Additionally, the last question is (3) how ASEAN could
implement a cross-border transaction system. To answer these questions, the author has
chosen the EU for comparison, as one of the best regions which first to unite and having a
respectable payment system integration mechanism and legal instruments. They have what are
known as Trans-European Automated Real-time Gross settlement Express Transfer system
(TARGET) and Single Euro Payments Area (SEPA). These two are integrated payment
systems for the EU member states. Both seem to have a systematic payment system
regulations and institutional body for the payment system, which ASEAN is likely to be able
to be adopted. In this research, the author will focus only on the instrument of TARGET as a
comparison, because TARGET uses the RTGS system as a cross-border transaction.

3. **Scope of the Research**

As the main issue of this topic is how to provide a legal basis for member countries in
a region, there will be unavoidable challenges in developing the regional law in this regard.
This dissertation will only focus on discovering a proper legal basis for an integrated payment
system (RTGS) in ASEAN, which might be applied for the ASEAN members. Such legal
basis should be implemented by all members and it should include settlement of disputes. In
order to accomplish these main objectives, the author will analyse the experience of the
European Union and will research the question of whether or not a payment system, such as
TARGET might be adopted by ASEAN.

Furthermore, since the legal setting of a region contains national and supranational,
the interaction between the members’ legal systems becomes unavoidable. A supranational
organization as institutional bodies is also one of the issues that should be considered for
discussion as a consequence of creating integration. The interface between the members’
national law will be one of the issues to be addressed. Moreover, supranational governance is
usually applied to situations outside the perimeter of corporate or governmental hierarchies,
mostly between the countries.

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24 In this research, the author will look at the EU’s experience in a comparative perspective in order to have a better understanding on the idea of proposing an RTGS integrated payment system as a tool to support the financial integration of the ASEAN region.

25 TARGET, stands for Trans-European Automated Real-time Gross Settlement Express Transfer System, is a cross-border payment system within the banks for the real-time processing throughout the European Union.

26 SEPA, stands for Single Euro Payments Area, is a payment-integration system, applied amongst the European members for bank transfers/transactions.

27 Supranational organizations are defined as being beyond the scope or borders of any one nation.
As we know, globalization is a complex concept. Globalization is regarded as a concept to capture the recently changing political interactions.\textsuperscript{28} So, again, the author emphasizes that this situation is influenced by political deals, but the author will limit this only to the legal aspect of the issues involved.

We can say that globalization and institutionalization are mutually inter-related concepts. R. Keohane’s opinion related to globalization and institutionalization is as follows:\textsuperscript{29}

\textit{“The relationship between globalization and institutional change does not only work in one direction. Globalization is fundamentally a social process, not one that is technologically predetermined. Like all other social processes, it requires the underpinning of appropriate social institutions. [...] Globalization and international institutionalization are mutually contingent.”}

It can be said that the multi-level structure of decision-making is no longer fully controlled by states, although they still play an important role, but is populated by non-state actors. The role of non-state actors could support government’s project and more participatory development, increasing involvement of citizens through their specific, often complementary approaches.\textsuperscript{30}

With regard to international institutionalization, the creation of Europeanization needs the interaction of three principal actors – states, supranational institutions and non-state actors. According to S. Tarrow:\textsuperscript{31}

\textit{“… the map of Europe today offers the potential for coalition building, political exchange, and the construction of mechanisms of alignment and conflict among social actors across states, sectors and levels of decision-making. These can take horizontal as well as vertical form. Regional governments, political parties and even social movements are reaching across and above their territories to exercise leverage against other actors, national states and supranational authorities.”}

Based on Tarrow’s model of triangular relations among states, supranational authorities and non-state actors, the form of Europeanization by the EU needs a supranational institutional arrangement with the involvement of those three actors.

\textsuperscript{28}Ondrej Cisar, “Between the National and Supranational?: Transnational Political Activism, Conflict, and Cooperation in the Integrated Europe”, Contemporary European Studies, 1/2007.


\textsuperscript{30}The role of non-state actors will be elaborated in chapter 3 and 4.

In the case of the Southeast Asian countries, they have different stages of economic development, different political ideologies and different legal systems. These various differences among the member states are challenges for the ASEAN member states to adjust and make more cohesive and integrated. In order to reach this goal, the ASEAN member states need to consolidate and expand the association’s legal basis. The integration of a payment system (RTGS) should be the focal points for ASEAN, in order to face the AEC 2015, especially to facilitate the trades and investments. Thus, in this dissertation, the proposed project of the integrated payment system (RTGS) does not for monetary union's objective, like the EU, but rather to facilitate the trades and investments program of the AEC 2015 for its financial integration and to support the single market project. In this dissertation, the author only selects a number of countries of ASEAN and the EU as an example, which will sufficiently represent both regions.

4. **Main Objectives of the Research**

Since this dissertation will focus on the question of how to develop a sound legal basis for the establishment and development of the payment system (RTGS) integration among the ASEAN member states, it is very important to know the EU’s approach in developing its integrated payment system (TARGET) for cross-border transactions among the members and how the EU settles disputes regarding payments through TARGET. Concerns and issues often arise in terms of choice of law and choice of forum.

This dissertation will describe and analyse what formal institutions will be needed to be involved at the regional and national level in order to balance the interests of the member states, on the one hand and the protection of customers in each member state, on the other hand.

This dissertation aims to create an appropriate ASEAN legal basis for payment system integration. Therefore, the main objectives of the research are:

- To propose an initiative for establishing an integrated payment system (RTGS) for the ASEAN member states in order to support the objectives of the AEC 2015.
- To provide a proper legal basis for payment system integration in ASEAN, especially for settling disputes.

5. **Research Method**

In order to achieve these main objectives, the author will analyse the development of the European Union’s payment system integration as a comparison. The scope of this analysis will cover the history of European integration, the making process of the creation of the

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32 The author will use and choose at least 3 member countries from each of both regions as examples which are sufficient and reasonable to represent both regions.
institutions and regulations. Considering that the ASEAN Economic Community is a new transformation of ASEAN and now is in the process of establishing the integration in payment systems, the assessment of the prospect of unification or harmonization of law on this topic at the ASEAN level will take a very important part in this research. In the end, the author will propose measures to determine a proper legal basis for payment system integration for ASEAN and also necessary steps via bilateral and/or multilateral agreement among the ASEAN participants, for the purpose of attaining safety and efficiency in payment systems and finally, protecting the interest of the ASEAN member states.

The method employed in this research will be applied by engaging a normative legal approach. The outcome of such an approach would provide beneficial input for deliberating the problems, which might occur, and finally will prescribe conclusions in respect of relevant issues discussed. Bearing in mind that the author’s background knowledge is predominantly the legal discipline, data that entails economic or other methods of data collecting will be retrieved from existing data banks that have been sourced or collected by preceding researches and organizations, such as the Bank for International Settlements (BIS), the International Monetary Fund (IMF), ASEAN, the EU, and the Central Banks.

This dissertation will be divided into six chapters, which will be elaborated, as follows:

In chapter one, the area of concern is to have a better understanding on the key concepts of a payment system in general and the RTGS in particular as the author’s choice instrument for a payment system. This will become the main research subject, including its characteristics and benefits. This chapter also describes the Core Principles of Systemically Important Payment System (CP-SIPS) and the Principles for Financial Market Infrastructures already used for assessment of the payment systems of most of the countries, including the ASEAN and the EU countries.

After describing the payment system, the author will describe in chapter two the history of the European monetary integration and also the European institutions, which play a role in the payment system area i.e. the European Central Bank (ECB) and the National Central Banks (NCBs). This chapter also describes the cross-border payment system which they use i.e. the integrated RTGS namely TARGET, and how they develop TARGET as a comparison, starting from the beginning of its establishment and including its structure of organization, objectives, features, and other measures.

The description in the previous chapter will then be followed by the situation in ASEAN itself in chapter three, which will describe two subjects i.e. ASEAN and the ASEAN Economic Community (AEC). In the first section, the author analyses the history and the scope of ASEAN; followed by the fundamental principles and the objectives of ASEAN, including the relations with countries outside of ASEAN; and ended with the conception of
the ASEAN Charter. The second section will explain the role of AEC, and then focus on the Role of the ASEAN Economic Committee as well as on the characteristic of AEC and its objectives. An overview of AEC from a legal and a political perspective is also elucidated. Here the characteristics and the objectives of ASEAN and the AEC will be presented. An integrated cross-border payment system (RTGS) is one of the instruments, which will help to achieve these objectives. In this chapter the author also provides the general description of the AEC priority sectors to face in 2015. The author will also deliver in the last part of this chapter the impact of the economic/financial integration onto the region’s character of its organization i.e. intergovernmental vs. supranational, learning from the EU for ASEAN’s dimension. The chapter will end with a glimpse of other region’s association in Latin America i.e. the Mercado Comun del Sur (MERSOSUR) as an additional comparison for ASEAN.

In chapter four, the author will analyse from a legal perspective, the legal basis that might fit the proposed project and its measures on a regional and national level. The analysis is including the capacity and role of both Public and Private International Law for settling the disputes that may arise by proposing a mechanism, which fits best for settling the disputes of this initiative and is expected to be used for other economic matter settlements. This chapter also describes the role of related parties that support the author's proposal. This chapter will describe also the key issues, which should be taken into consideration for further research related to such initiative. In this chapter, the author would like to explain the role of the Working Committee on Payment and Settlement System (WC-PSS) and the relation to the proposed project, which also might be able to support the author's proposal and finally supporting the objective of the WC-PSS and ultimately, the objective of the AEC.

The author will then elaborate in chapter five the role of Indonesia in ASEAN and the development of Payment Systems to support the AEC, including the challenges for Indonesia in facing the AEC 2015.

Finally, the conclusions will be presented in chapter six and this will be the end of the discussion on the legal basis of implementing the initiative for an integrated payment system (RTGS) and the possibility of adopting the conduct of the EU. In this chapter, the author also includes suggestions and recommendations for the next step and for further research.
CHAPTER 1
A PERSPECTIVE TO AN INTEGRATED PAYMENT SYSTEM (RTGS) IN ASEAN

1. The Key Concept of Payment System

1.1 Introduction

The commitment of AEC 2015 triggered the ASEAN members to raise the level of economic integration. The movement to conclude Free Trade Agreements prompted the ASEAN leaders to start the creation of a common market through the strengthening of financial cooperation. The rapid movement of cross-border transactions among the ASEAN members and global trends such as the formation of regional economic zones in European Union, inspired the ASEAN leaders to create a single market among its members.

From this perspective, it can be seen that the purpose of establishment is not only for common interests, but also for the long-term economic development in the region. The payment systems integration is one of the targets that ASEAN need to achieve. Properly functioning payment systems enhance the stability of the financial system, reduce transaction costs in the economy, promote the efficient use of financial resources, improve financial market liquidity and facilitate the conduct of monetary policy. Payment systems may be beneficial not only for government but also for private sectors and customers. The key factors in payment systems are safety, reliability and efficiency. Safety means that every transaction should be safe starting from the sender to the receiver, no matter what the amount is. Reliability means that the system can be trusted and can be developed accordingly. Efficiency means that the transaction should be less costly and should arrive in a timely manner in the hand of beneficiary (receiver).

In this chapter, the author provides an overview of the concept of payment system, such as instruments, principles and responsibilities for Financial Market Infrastructures (FMIs) and Payment System (RTGS) as key concept of integration for ASEAN; the role of payment system in a market economy and regional payment system integration.

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1.2 Global Perspectives on Payment Systems

A payment system, according to Humphrey, at its most basic level, is merely an agreed upon way to transfer value between buyers and sellers within a transaction. Rodrigo in his opinions states that a payment system is a network of banks in which funds transfers are made during the day. Torreja points that the payment system is important for the smooth functioning and integration of the financial market. The payment system also affects the transmission process in monetary management, the pace of financial deepening, and the efficiency of financial intermediation. Thus, monetary authorities have typically been active in promoting sound and efficient payment systems and in seeking means to reduce related systemic risks.

A country’s payment system relies on both cash and non-cash payments. Cash is provided by the government, while non-cash payments are typically provided by the banking system using either deposit balances in transaction accounts or credit balances. The further shift from paper to electronic payments is quite recent, starting only about 20 years ago. Many countries around the world have already recognized the alterations of the payment systems. Payment systems at the beginning were provided by the central bank. Later, new technology became so rapid and the involvement of private sectors as a provider of payment systems plays an important role in the payment systems industry, such as the Singapore dollar (SGD) cheque clearing, the US dollar (USD) cheque clearing and the interbank GIRO clearing services provided by the Singapore Automated Clearing House (SACH), which is operated by the Banking Computer Services Pte Ltd (BCS).

The term “clearing” is the process of transmitting, reconciling and, in some cases, confirming payment orders or security transfer instructions prior to settlement, possibly including the netting of instructions and the establishment of final positions for settlement. Sometimes the term is used (imprecisely) to include settlement. In other words, it is a due process that serves as a mechanism for the settlement of obligations among the parties, usually between banks. In this case, two or more banks should fulfil their obligation for

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37 Ibid.
40 Monetary Authority of Singapore (MAS) appoints the private sector as a provider for clearing house.
money exchanged which effected from their transactions and this must be cleared and settled among them before final payment. The term of settlement signifies the completion of a transaction, wherein the sellers transfer securities or financial instruments to the buyer and the buyer transfers money to the seller, usually known as final settlement which is an irrevocable and unconditional transfer which effects a discharge of the obligation to make the transfer.\textsuperscript{42} In this sense, a payment system comprises of three main elements or processes.\textsuperscript{43}

\begin{quote}
1. payment instruments, which are a means of authorizing and submitting a payment (i.e. the means by which the payer gives its bank authorization for funds to be transferred or the means by which the payee gives its bank instructions for funds to be collected from the payer);
2. processing (including clearing), which involves the payment instruction being exchanged between the banks (and accounts) concerned;
3. a means of settlement for the relevant banks (i.e. the payer’s bank has to compensate the payee’s bank, either bilaterally or through accounts that the two banks hold with a third-party settlement agent)."
\end{quote}

A payment system also relies on institutions that provide payment accounts, instruments and services to customers (including consumers, businesses and public administrations) and also on organizations that operate payment, clearing and settlement services (such as interbank funds transfer systems).\textsuperscript{44}

Nakajima states that the evolution of the payment systems will never stop. Payment systems are social infrastructures that support all economic activities, and the financial market will require in the future more sophisticated payment systems with greater safety and efficiency.\textsuperscript{45} The author agrees with Masashi’s opinion that the payment system development is always revolutionized and should be followed by dynamic regulations, but the regulation itself usually comes up relatively late. The author also argues that safety and efficiency are the most important elements in the payment systems development and they support the functions of the financial market and the financial system.

\subsection*{1.3 The Component of Payment Systems}

Payment systems, which consist of a legal framework, rules, institutions, and technical mechanisms for the transfer of money, according to B. Summers are an integral part of the monetary and financial systems in a smoothly operating market economy.\textsuperscript{46} According to

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{42}Ibid., pp.24 and 45.
\item \textsuperscript{43}Tom Kokkola, (ed)., “The Payment System”, European Central Bank Paper, 2010, pp.25.
\item \textsuperscript{44}Ibid.
\end{itemize}
\end{footnotesize}
Bank Indonesia (the Central Bank of the Republic of Indonesia), the payment system is a system that covers the legal and regulatory framework, institutions and mechanisms used to transfer funds in order to settle liabilities arising from economic activities. The payment systems have components or elements, which explain the complexity of handling an efficient, effective and reliable payment system. To a large extent, the efficiency of transactions in a market economy is determined by the efficiency of the payment system.

The components of the payment system contain six elements i.e. policy, institutions, payment instruments, operational mechanisms, infrastructure, and legislation. These elements are elaborated by the author as follows:

- **Policy**
  The policy component means that a country requires its payment system to match with the history, characteristics and needs of that payment system of its country. For example, the country whose history and characteristic is a trade nation, has a totally different policy in making the payment system from a country in which trade is not so needed. The trade countries will need more efficient and sophisticated systems to meet their needs, whereas the countries in which trade is not so important will only need a simple system to meet their requirements. From this, we can understand that the needs of each country in building a payment systems differ from one to another, so that the policy to create a payment system will also differ for each country. For example, Indonesia and Singapore created a payment system which is also facilitating the use of a Giro, where the other member countries are not familiar of using the Giro.

- **Institution**
  The players who provide payment services generally can be categorized into two big parties i.e. banks and non-bank institutions. In Indonesia, the players can be grouped into banks and other related institutions. The banks itself includes the central banks

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48Hancock, _Op cit._
50Giro instrument, is a method of payment which is different from Cheque instrument, where the recipient disbursement of funds cannot be received in cash, but through the book-entry to the relevant account (Bank Indonesia definition see at. In Indonesia, the total amount of volume/transaction and value of Giro instrument always greater than the use of cheque instrument as seen in the statistic in November 2014, at http://www.bi.go.id/en/statistik/sistem-pembayaran/kliring/contents/kliring%20debet%20penyerahan.aspx, last accessed on January 15, 2015. In Singapore, Giro instrument also greater used than cheques by volume of transactions, at http://www.mas.gov.sg/~media/MAS/Singapore%20Financial%20Centre/Why%20Singapore/Payment%20and%20Settlement%20Systems%20redirect%20pages/H1%202014%20Retail%20Payment%20Statistics.pdf, last accessed on January 15, 2015
and the commercial banks. The other related institutions called non-bank financial institutions, such as leasing companies, venture capital and also postal offices, also play an important role as a source of finance but they undertake very limited activities with respect to payment services. Malaysia also has two big group play-actors i.e. the Central Bank of Malaysia (BNM) and the commercial banks in one group and finance companies such as credit/charge card companies.\textsuperscript{52}

- Payment Instrument
Payment instruments usually are used for retail transactions and divided as follows:

  - Cash Payment
    Cash payment consists of coins and bank notes. Indonesian currency is Rupiah and the currency of the other ASEAN countries are Ringgit (Malaysia), Singapore Dollar (Singapore), Brunei Dollar (Brunei), Peso (Philippines), Baht (Thailand), Vietnamese Dong (Vietnam), Kyat (Myanmar), Cambodian Riel (Cambodia), and Lao Kip (Lao PDR).

  - Non-Cash Payment
    - A Cheque is a written order from a customer (the drawer) to his bank (the drawee) to pay a specified amount to a third party specified by the drawer.\textsuperscript{53} Cheques are generally valid until six months after the date of issue and these are used for future promise to pay the amount specified on them and must be presented to the issuing bank in order to get the payment.

    - A Debit Card is a card enabling the holder to have his purchases directly charged to funds on his account at a deposit-taking institution.\textsuperscript{54} From an academic perspective, Indiana University has defined the debit card as a payment card whose funds are withdrawn directly from the cardholder’s checking account.\textsuperscript{55} It means that if the funds in the account of the cardholders are not sufficient, they are not be able to pay or to make transactions with their card. It can be used also for online purchases. The cardholders should have a deposit at a bank or a non-bank approved to accept deposit funds.\textsuperscript{56}


\textsuperscript{54}\textit{CPSS, Op. cit., pp.19.}

\textsuperscript{55}\textit{Indiana University website, “Glossary of Payment Card Term”, at http://www.indiana.edu/~iutreas/pmtcardterms.html, last accessed on January 15, 2015.}

A Credit Card by the definition of Bank Indonesia\textsuperscript{57} is a Card-Based Payment Instrument that may be used to execute a payment of an obligation incurred in an economic activity, including purchase transaction and/or a cash withdrawal, in which the payment obligation of the cardholder is settled in advance by the acquirer or issuer and the cardholder is required to fulfil the payment obligation at an agreed term in a single payment or in instalments. It is used for the actual transaction but the payment itself will be fulfilled in the future by the cardholders. Credit cards are developed to make payments from credit accounts instead of deposit accounts, so cardholders can consume first and pay later.\textsuperscript{58} The transactions themselves have a limitation amount. The settlement is at a later date and the cardholders are billed on a monthly basis with financial charges (interest rate and late charges) for outstanding payment and not made the payment by the due date. Additionally, a credit card is a revolving credit instrument, which does not need to be paid off in full. \textsuperscript{59} No late fee is charged as long as the minimum payment is made, which carries a balance forward as a loan charging interest. The credit card can have a grace period, which the customer has to pay only the interest. In addition to payment services, international credit cards also offer insurance, concierge and other value-added services that come to cardholders with the card.\textsuperscript{60}

- Internet and Mobile Banking, according to Bank Negara Malaysia (BNM), provide a fast and convenient way of performing common banking transactions.\textsuperscript{61} According to KPMG, mobile banking refers to platforms that enable customers to perform banking activities by way of accessing their accounts and doing other financial services such as transfers, bill payments, balance information and investment options.\textsuperscript{62} BNM also enables payments

\textsuperscript{57}Ibid.  
\textsuperscript{60}Ann Borestam, Heiko Schmiedel, \textit{European Central Bank}, Occasional Paper Series No.131/September 2011, Interchanges Fees in Card payment System at http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp131.pdf, last accessed in January 15, 2015. In the EU, for example, the credit card schemes as three -party schemes are American Express and Diner’s Club, and four-party schemes are debit and credit card schemes comprise Visa Europe, MasterCard and Cartes Bancaires.  
\textsuperscript{62}See KPMG website, “Monetizing Mobile: How banks are preserving their place in the payment value chain”, July 2011, at https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Monetizing-mobile-201107.pdf, last accessed January 15, 2015. There is a difference with mobile payment which is defined
to selected merchants by using mobile phones. Other ASEAN countries, which also develop the use of mobile payment, are Indonesia and Philippines.

- **Operational Mechanisms**
  An operational mechanism means that the system should ideally guarantee the smooth transfer of funds and security, as well as certainty of the receipt of funds by the recipient. In this regard, the system that will be discussed in this research is the Real Time Gross Settlement (RTGS) system.

- **Infrastructure**
  The payment system infrastructure depends on the needs and policies of the central bank as the primary role of a country. The more advanced the demands of the capacity and capability of the technology, the higher the budget for the system. The payment system should have a standard platform based on interoperable standards. This is very important in making a uniform platform for the ASEAN member states, as it will be easier for the members to run it.

- **Legislation**
  The other important component is legislation. The rules will govern the numerous participants involved, such as, banks, the capital market, clearing institutions and even between central banks. The regulations are needed to legitimate the implementation of payment systems. They are also needed to support the development of the payment systems, and hence, is one of the most important aspects for the payment systems.

### 1.4 Types of Payment System

There are many types of payment systems, but among the members of ASEAN and the EU, the categories of types of payment systems seem to be similar. There are basically two types of payment systems: the Deferred Net Settlement (DNS) system and Real Time Gross Settlement (RTGS) System, which is recommended by the Bank for International Settlement (BIS).\(^6\) Like the above mentioned, with net settlement system, banks obviously spend less on liquidity needs, but are vulnerable to systemic risks. By using gross settlement system (RTGS), interbank payments are settled at once as they send the money. Hence, this clearly reduces the risks because there is no time lag between delivery of payment order and settlement.

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1.4.1 Types of Payment System in ASEAN

- In Indonesia, Bank Indonesia divides payment systems into eleven parts. But the Interbank payment system itself in Indonesia is divided into two types of payments i.e. the Large Value Payments named BI-RTGS and the Retail Payments. Retail Payments are settled at BI and are divided into two types i.e. Clearing system and ATM Bersama (Credit Card/Shared ATM). The other credit card/shared ATM transactions settled by commercial banks are ALTO, CAKRA, Flash and ATM BCA. The securities settlement system is regulated by a Security Body and its sub body, PT KSEI whereby transactions are settled by its appointed settlement banks (see Table 1).

Table 1
Various Payment Systems in Indonesia

<table>
<thead>
<tr>
<th>System</th>
<th>Transactions Processed</th>
<th>Operator</th>
<th>Members</th>
</tr>
</thead>
</table>
| Bank Indonesia Real Time Gross Settlement (BI-RTGS) System | - High value interbank electronic funds transfers  
- Settlement: interbank money market, customer transfers, government transactions and monetary management  
- Funds settlement for Bank Indonesia Certificates and Government Securities traded on the BI-Scriptless Securities Settlement System (BI-SSSS) | Bank Indonesia                    | - All banks in Indonesia, including sharia divisions (143 banks)  
- One switching company |
| Bank Indonesia Clearing System            | - Debit funds transfers by means of electronically processed cheques, *bilyet giro*, debit notes  
- Credit funds transfers processed electronically for small payments | Bank Indonesia                    | All banks in Indonesia (143 banks including all branch offices numbering about 2100) |
| Central Depository and Book Entry Settlement System (C-BEST) | Funds settlement for securities transactions on the capital market | Indonesian Central Depository (PT KSEI) | All stock exchange members, funds settlement conducted through 4 settlement banks where stock exchange members maintain settlement accounts |
| Shared ATM Network – National Brands      | Electronic funds transfers by means of ATM cards | PT Artajasa Pembayaran Elektronis (ATM) | 67 banks are members of the ATM-Bersama network, interbank settlement processed |

65 Ibid.
<table>
<thead>
<tr>
<th>System</th>
<th>Transactions Processed</th>
<th>Operator</th>
<th>Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bersama)</td>
<td>through the BI-RTGS system</td>
<td>LINK</td>
<td>4 state banks, interbank settlement processed through the BI-RTGS system</td>
</tr>
<tr>
<td>PT Rintis Sejahtera (PRIMA)</td>
<td>ATM and Debit Prima network settlement processed through member accounts at BCA. Membership totals 25 banks.</td>
<td>PT Daya Network Lestari (ALTO)</td>
<td>15 banks are members of the ALTO network, settlement processed through member accounts at one member bank.</td>
</tr>
<tr>
<td>Cakra</td>
<td>3 banks are members of the Cakra network, settlement processed through member accounts at one member bank.</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Intrabank ATM Networks**

Electronic funds transfers using ATM cards for book entry account transfers at the same bank.

- 70 banks provide this facility
- 9 banks are Cirrus members, settlement processed through member accounts at one member bank.
- 10 banks are Plus members, settlement processed through member accounts at one member bank.
- -

**Shared ATM Network – International Brands**

- MasterCard International (Cirrus)
- Visa International (Plus)
- -

**Debit Card Networks – National Brands**

Electronic transfer at Point of Sale (POS)

- BCA (Debit BCA) 16 banks are members of Debit BCA
- Kartuku 2 banks are members, settlement processed through member accounts at one member bank.

**Debit Card Networks – International Brands**

- Visa International (Visa Electron) 10 banks are members, settlement processed through member accounts at one member bank.
- MasterCard International (Maestro) 9 banks are members, settlement processed through member accounts at one member bank.

**Credit Card Networks**

Electronic payment by credit card

- Visa International 15 banks are members, settlement processed through member accounts at one member bank.
<table>
<thead>
<tr>
<th>System</th>
<th>Transactions Processed</th>
<th>Operator</th>
<th>Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>MasterCard International</td>
<td>13 banks and 1 NBFI are members, settlement processed through member accounts at one member bank.</td>
<td>MasterCard International</td>
<td>member bank.</td>
</tr>
<tr>
<td>JCB</td>
<td>2 banks are members, settlement processed through member accounts at one member bank.</td>
<td>JCB</td>
<td></td>
</tr>
<tr>
<td>Diners Club</td>
<td>1 member (Diners)</td>
<td>Diners Club</td>
<td></td>
</tr>
<tr>
<td>Funds transfers/remittances – domestic networks</td>
<td>PT Pos Indonesia (postal money orders)</td>
<td>PT Pos Indonesia (postal money orders)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Courier companies providing cash delivery services</td>
<td>Courier companies providing cash delivery services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other companies specialising in remittance services</td>
<td>Other companies specialising in remittance services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Money changers offering remittance services</td>
<td>Money changers offering remittance services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shops and travel agents also offering remittance services</td>
<td>Shops and travel agents also offering remittance services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Others (not identified)</td>
<td>Others (not identified)</td>
<td></td>
</tr>
<tr>
<td>Funds transfers/remittances – international networks</td>
<td>Funds transfers/remittances with receipt in cash or beneficiary account - international payments only.</td>
<td>Western Union</td>
<td>One bank, PT Pos Indonesia and non-bank companies operating as agents for Western Union</td>
</tr>
<tr>
<td></td>
<td>Money Gram</td>
<td>Money Gram</td>
<td>Some banks and non-bank companies, such as shops and travel agents, operating as agents for Money Gram.</td>
</tr>
<tr>
<td></td>
<td>Others (not identified)</td>
<td>Others (not identified)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank Indonesia

- In Thailand, Bank of Thailand (BoT) classifies payment instruments into seven channels,\(^66\) i.e. use of cash, cheque, high-value funds transfer called BAHTNET, bulk payment, retail funds transfer\(^67\), electronic card and e-money.

In Malaysia, BNM categorizes payments into two groups: Large Value Payment Systems (RENTAS) and Retail Payment System. The latter is further divided into three, based on the types of retail payment systems, payment instruments and payment channels (see Figure 1). Amir in his paper categorizes payment systems into four big groups: The Large Value Payment Systems named the Real-Time Electronic Transfer of Funds and Securities (Sistem Pemindahan Dana dan Sekuriti secara Elektronik Masa Nyata, also known as RENTAS); the National Image-based Check Settlement System, (Sistem Penjelasan Imej Cek Kebangsaan, also known as SPICK); the Automated Teller Machine (ATM) and other retail payment networks; and the Clearinghouse operating under the control of the Malaysia Securities Exchange Berhad and the Malaysia Derivatives Exchange Berhad.

Figure 1
Types of Payment System in Malaysia

Source: Bank Negara Malaysia

- Vietnam, as the new ASEAN member, also has similar payment system types. According to Le Anh Dung, the electronic payment systems are divided into three i.e. the inter-bank electronic payment system (IBPS), Electronic Clearing System and Card Payment System. The IBPS is composed of two sub-systems: High Value Sub-system

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(HVTS), the RTGS for large-amount remittances on a gross basis, and Low Value Subsystem (LVTS) for small-amount remittances on a net basis.\footnote{Ibid.}

- In Philippines, there are six major payment, clearing and settlement systems i.e. Electronic Check Clearing System (ECCS), Electronic Peso Clearing and Settlement System (EPCS), Philippine Domestic Dollar Transfer System (PDDTS), Philippines Dealing System (PDS) Settlement Highway (PSH), Automated Teller Machine (ATM) and Philippine Payments and Settlements System (PhilPaSS) which is known as RTGS.\footnote{See BSP website, “What is a Payment System?”, at http://www.bsp.gov.ph/financial/payments/PhilPaSS.pdf, last accessed on January 16, 2015.}

- In Cambodia, they divide the payment mechanisms and credit instruments into two distinct major types based on The Negotiable Instruments and Payment Transactions Law (The NIPTL of Cambodia).\footnote{Geva, Benjamin, “Payment System Modernization and Law Reform in Developing Nations: Lessons from Cambodia and Sri Lanka”, Banking Law Journal, ALEXeSOLUTIONS, Inc, May 2009.} The first one is Negotiable Instruments, namely checks, bills of exchange and promissory notes. The second type covers payment transactions: non-cash payments carried out through banks, executed in either electronic or paper-based systems.

1.4.2 Types of Payment System in the European Union

- In De Nederlandsche Bank (DNB), payment systems are categorized into two: Interpay and Top/Target (see Table 2). Interpay Nederland B.V. is the central clearing institute for retail payments set up by the banks with a view of promoting and maintaining efficient payment processing and reliable payment systems.\footnote{The Committee on Payment and Settlement Systems of the Group of Ten Countries in Red Books, “Payment and settlement systems in selected countries”, Bank for International Settlements, 2003, pp.297.} Large value payments are processed via TOP, the RTGS system, which is owned and operated by the Netherlands Bank. TOP was also developed to cross-border payments via TARGET\footnote{After the RTGS is linked with the TARGET system, the RTGS system is replaced by TARGET which is operated by the DNB but is no longer owned by the DNB.} to which TOP is linked.\footnote{Red Books, Op. cit, pp.291.} The European Union countries have all installed RTGS systems.\footnote{Furfine,Craig H. and Jeff Stehm, “Analyzing alternative intraday credit policies in real-time gross settlement systems”, Journal of Money, Credit, and Banking 30, Ohio State University Press, 1998, pp.833.} These systems, in turn will be linked through the proposed Trans-European Automated Real-Time Gross Express Transfer (TARGET) system, which is a necessary pre-condition for a monetary union.\footnote{European Union Report 1992, 1993 and Gianninni and Monticelli 1995, in Craig H. Furfine, and Jeff Stehm, “Analyzing alternative intraday credit policies in real-time gross settlement systems”, Journal of Money, Credit, and Banking 30, Ohio State University Press, 1998, pp.833.}
Table 2
Payment systems in the Netherlands

<table>
<thead>
<tr>
<th>Payment systems</th>
<th>Assessment of setup</th>
<th>Assessment of operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interpay</td>
<td>DNB</td>
<td>DNB</td>
</tr>
<tr>
<td>TOP/TARGET</td>
<td>DNB</td>
<td>DNB</td>
</tr>
</tbody>
</table>

Source: http://www.bis.org/cpss/paysys/NetherlandsComp.pdf, last accessed on January 15, 2015. (modified)

- The structure of the French payment systems is also divided into two types of payment systems: retail payment system and large value payment systems (see Figure 2).\(^{79}\) The single retail system is operated by the French automated clearing house, SIT, which is managed by the GSIT, a group of 17 participants (including the Bank of France). The large value operations are processed in two systems: the RTGS system Transferts Banque de France (TBF), which is the French component of TARGET, managed and operated by the Bank of France; and the Hybrid system Paris Net Settlement (PNS), managed and operated by the Centrale des Reglements Interbancaires (CRI), an interbank body owned by 10 banks and the Central Bank.\(^{80}\)

Figure 2
Payment Systems in France

Source: BIS – Red Books, pp.122

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\(^{80}\)Ibid.
1.5 Payment System Risks

Like other systems, payment systems also have risks. The Federal Reserve states that the basic risks in payment and settlement systems are credit risk, liquidity risk, operational risk, and legal risk. In the context of this policy, these risks are defined as follows.

- **Credit Risk.** The risk that a counterparty will not settle an obligation for full value either when due, or anytime thereafter.
- **Liquidity Risk.** The risk that a counterparty will not settle an obligation for full value when due.
- **Operational Risk.** The risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events. This type of risk includes various physical and information security risks.
- **Legal Risk.** The risk of loss because of the unexpected application of a law or regulation or because a contract cannot be enforced.”

The Bank for International Settlements (BIS) and Bangko Sentral ng Pilipinas (BSP), also identified the possible risks related to payment systems, as follows:

- **Credit risk.** The risk that a party within the system will be unable to fully meet its financial obligations within the system either when due or at any time in the future;
- **Liquidity risk.** The risk that a party within the system will have insufficient funds to meet financial obligations within the system as and when expected, although it may be able to do so at some time in the future;
- **Legal risk.** The risk that a poor legal framework or legal uncertainties will cause or exacerbate credit or liquidity risks;
- **Operational risk.** The risk that operational factors such as technical malfunctions or operational mistakes will cause or exacerbate credit or liquidity risks; and
- **Systemic risk.** The risk that the inability of one of the participants to meet its obligations, or a disruption in the system itself, could result in the inability of other system participants or of financial institutions in other parts of the financial system to meet their obligations as they become due. Such a failure could cause widespread liquidity or credit problems and, as a result, could threaten the stability of the system or financial markets.”

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Hancock has a different opinion. Fraud, operational and systemic risks exist in all payment systems. Hancock further explains that:

"**Fraud risk** is addressed through proper internal payment processing procedures and insurance. **Operational risk** is addressed through limited access to sensitive facilities and, especially for large-value payment networks, the establishment of back-up or duplicate computer facilities. **The systemic risk** involves the potential for a domino-like series of failures among participants on a payment network resulting from the unexpected failure of one or more participants to settle their intra-day net debit positions."

In gross settlement, such risks is less than in net deferred settlement. In gross settlement, for example, credit risk and settlement risk, is reduced because cash is transferred between banks continuously in real time, transaction by transaction. Every payment is settled finally and irrevocably in central bank money. Bank of Thailand also states the following:

"**Risks in payment systems refer to the possibility of payments being incomplete. Such risks generally exist in the payment systems that are not settled on a real-time basis i.e. net settlement systems, whereby the longer the time difference between payment and settlement time, the higher the risk exposure it is. Moreover, the risks will also depend on the volume and value of transactions in the payment system. Causes of payment system risks vary to the type of risks, major causes are counter party risk i.e., Liquidity and Credit Risks**"

So, the author argues that a net settlement system is a designated time settlement system, in which final settlement takes place at a certain time, at the end of the day. On the other hand, the RTGS system has two structures. The first one is that the settlement of funds occurs on a gross basis and the second part is the payment becomes final immediately. We can conclude that the RTGS system is less risky than the netting system.

Masashi emphasizes that the RTGS system is far superior to the DNS system in terms of settlement risk. He describes that the RTGS system achieves finality earlier, which reduces credit and liquidity risk. On top of this, he states that there is no “systemic risk” in the RTGS system. The author agrees with his statement that the RTGS diminishes credit and legal risk.
liquidity risk because the RTGS’ maxim is “no funds no game”. The author adds that a good system should be followed with sufficient regulations.

1.6 Significant Factors in Payment and Settlement System

A payment system must be tailor-made or specially designed to meet and satisfy the unique requirements of a particular country. This means that each country is able to design the payment and settlement system according to its own characteristics. However, there are significant factors that should be complied with for the success of the systems. Negret, et al, describe these factors as follows:

- **Speed.** Users must be confident that a payment, which has been initiated, will be completed to the right party for the correct amount and within a prescribed period of time.

- **Certainty.** A critical requirement in any payment system concerns certainty of payment, that is, the point at which funds are irrevocably available for use and there is settlement finality. Payments can carry immediate finality, so that the funds are irrevocably available for use without delay.

- **Reliability.** A payment system must be reliable if it is to maintain user confidence. Although no system will always operate faultlessly, all systems must have adequate contingency or fall-back provisions and controls, and adequate backup capabilities in case one or more major processing stations fail.

- **Safety and Security.** The safety and security of payments are important. Particular attention must be given to fraud control and credit risk control related laws and rules to resolve disputes promptly and fairly. Special attention must likewise be given to adequate arrangements for protection against unauthorized access or tampering with payment system data, and to a mechanism that will ensure confidentiality and minimize exposures among participants.”

2. **RTGS System**

The author would like to focus on, and bring the attention to the inter-bank funds transfer system called Real Time Gross Settlement (RTGS) also known as a Large Value or High Value payment system (HVPS) transfer transaction which has no credit risk. The RTGS is the continuous (real-time) settlement of funds or securities transfers individually on an order-by-order or gross basis (without netting). Real time means that the processing of

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instructions is done on an individual basis at the time they are received rather than at some later time\textsuperscript{92} or the transaction takes into effect as soon as funds are transferred by the remitting bank. Gross basis means that the transaction is settled on one to one basis without being bundled with any other transaction. This payment and settlement system clearly reduces the risks of the member of banks and provides speed, certainty of finality, reliability and safety and security. This system would be further explained and discussed, as part of an integration payment and settlement system among the ASEAN members.

As mentioned above, an RTGS system is defined as a gross settlement system in which both processing and final settlement of funds transfer instructions can take place continuously (i.e. in real time). As its name, all settled transactions are considered as final and irrevocable. Thus the receiver is able to use the funds immediately without being exposed to the risk of the funds not being settled.\textsuperscript{93}

As its name, indicates, it is used for a large value or wholesale intra banks payment, so for these large transactions, the participating banks should have the holding of liquid assets in their central bank accounts, which is costly for them. Related to this issue, Charles and William state that in almost all RTGS systems, central banks provide intraday credit to participating banks.\textsuperscript{94} The terms for such credit vary from system to system, though, in most cases, credit is only available in limited amounts or at some cost.

With respect to the cost, Furfine and Stehm take into account the design of an RTGS payment system, especially concerning the intraday credit.\textsuperscript{95} The design of placing intraday credit must be well organized in order to avoid the participants’ reluctance in processing payments using an RTGS system as a consequence of certain expenses that the system imposes on its members. This should be the ASEAN central banks’ concern to manage the cost of intraday credit as one important factor in determining the cost of RTGS for participants. Since it is technical, the author will not discuss this issue.\textsuperscript{96} The flow of RTGS is provided in Figure 3 below.

\textsuperscript{92}Ibid., pp.40.
\textsuperscript{93}Torreja Jr., Op cit., pp.78.
\textsuperscript{96}The author does not want to describe further of intraday credit because it is too technical. It simply can be said that intraday credit is for a participant that needs some loan for smoothing its transaction because on that day the participant does not have sufficient funds to make transactions. This credit should be paid back in the end of the day. There is a right and obligation related to this credit.
2.1 The Characteristics of the RTGS

The characteristics of the RTGS are similar in most countries. The author would like to summarize the key characteristics Bank Indonesia provided, as an example:97

1. V-shaped structure.
   It means that the message is conveyed from sending members to receiving members through BI-RTGS. This structure explains that all information pertaining to a transaction will be transmitted by the sending member to the RTGS Central Computer (RCC) and forwarded to the receiving member if the transfer is settled by BI.98

2. Members.
   The BI-RTGS has two categories of members: Principal members (direct participants) and subsidiary members (indirect participants). There are two tier systems.

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98 V-shaped structure with messages, conveyed from sending members to receiving members through Bank Indonesia in its capacity as the RTGS operator. In this structure, the message with all the information related to the payment is initially passed to the central bank and is simultaneously sent to the receiving bank after the transfer has been settled by the central bank. Y-shaped structure uses the swift network and the information exchanged between the sending and the receiving bank is not acknowledged by the central bank as a settlement operator. The central bank only checks the sufficient money of the account of the participants and then informs the network.

The mechanism of BI-RTGS is similar to other RTGS among the ASEAN members. There are two terminals, i.e. RTGS Terminal (RT) for sending a message which is received by BI in RTGS Central Computer (RCC). RCC then checks for sufficient balance in the account of the sending member and if it is the case, the transactions will be posted simultaneously to the account of the sending members and the receiving members.


The time available is from 06.00 until 16.30 hours of local time. It can be prolonged to accommodate needs. The window time depends on the policy of each central bank, including holidays.

5. *No Money No Game.*

This is also similar to other RTGS system. This means that the members have to manage their liquidity with great care to ensure that all transactions can be duly settled. This is what we call a credit transfer, which means that if there is no sufficient money in the account of the bank,\(^9^9\) the transaction will be stopped or delayed by the system.


BI has determined a cap on clearing transactions in order to reduce the number of transactions processed in clearing so that the net settlement risks are minimized.

7. *Queue Management and Gridlock Resolutions (GR).*

Once the balance account of the member to be debited is less than the transaction that they sent, the transaction will be placed in the BI-RTGS queue system. The system has priority levels to settle the queuing transaction. BI-RTGS can also detect gridlock, and then this GR facility will operate either automatically or manually.

8. *Intraday Liquidity Facility (FLI) and Short-Term Funding Facility/STFF (Fasilitas Pendanaan Jangka Pendek/FPJP).*

As explained above, members of RTGS are required to maintain considerably large amounts of liquidity during the day. To have this facility, the members must have a fairly sound rating and must pledge collateral with very liquid assets, such as government bonds. Should the members be unable to make repayment of the FLI they received from Bank Indonesia, it will be converted into an overnight FPJP. Until T+1, if the members still have insufficient funds for repayment of the FPJP, then the repayment shall be settled by liquidating the collateral.

These characteristics, once again, are generally similar to the ones seen in the ASEAN members and most of the countries in the world. The differences in the system of every member country are commonly concerned with: (1) the amount or percentages of the

\(^9^9\)When the banks have no sufficient money, they can use intraday liquidity facility to continue transactions. This mechanism will not be elaborated further.
collateral that should be pledged in the Central Bank account; and (2) the repayment period or what we call the management credit and liquidity risks policy. In Vietnam, for example, SBV requires the member banks to deposit valuable securities (including government bonds) as a collateral with SBV before they may receive such facilities. SBV will sell the collateral if, after providing overnight facilities, there is still no fund repayment within four days.\(^{100}\)

### 2.2 The Benefits of RTGS system

The benefits of an RTGS system to its major users are the following:\(^{101}\)

1. **Flexible liquidity management.**
   In RTGS, liquidity will be available to participants at all times through provision of collateralized intraday credit to the participants. The participants can ask for the liquidity at any time during the window time. This system is better than netting settlement, where the liquidity is trapped until end-of-day settlement.

2. **Risk reduction.**
   An RTGS system can provide a firm foundation for the management of payments system risks as it can give participants the possibility of settling payments in central bank money with immediate finality, thus eliminating the settlement risk between participants, which is inherent in other payments mechanisms. This means that participants will, in principle, only pass on customer money that they receive to the final beneficiary without any credit risk (no money no game).

3. **Real-time operation.**
   For cross-border RTGS payments, under normal circumstances, the lag time between the debiting of the account of the sending participant and the crediting of the account of the beneficiary participant will almost be nil.\(^{102}\) The rapid processing of funds, which will be credited to the appropriate account with finality, will yield direct benefits for participants. Moreover, with RTGS, international corporate cash management will be able to make substantial efficiency gains. The real-time execution of RTGS payments will reduce the float and make it possible to optimize cash management.\(^{103}\)

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\(^{101}\)Summarizing from Wilhelmina, *Opit*. Major users in this term are the participants in the following transactions: a) business to corporate; b) corporate to corporate; and c) bank to bank

\(^{102}\)Theoretically, according to the ECB, the RTGS system needs less than 5 minutes to process the money from the transferring to the receiving money. See at http://www.ecb.europa.eu/paym/t2/html/index.en.html, last accessed on January 16, 2015.

\(^{103}\)A payments system float is the balance sheet effect of crediting (in a debit transaction like a check) or debiting (in a credit transaction like a payment order) the bank account of the entity originating a payment before the
4. Accurate and reliable transmission of information in RTGS payment messages.

No payment-related information will be lost in RTGS. The payment instruction, if provided in accordance with the standards, will always be forwarded in its entirety to the beneficiary participant. It means that the participants will get the complete confirmation report.

5. Cost savings.

The fee charged for RTGS transactions will be based on the number of transactions made by a participant. The RTGS will result in cost savings for the following reasons:\textsuperscript{104}

\textit{\textbf{- Incoming funds will be available for immediate re-use;}}
\textit{\textbf{- It will be possible to reconcile accounts on an intraday basis;}}
\textit{\textbf{- Immediate reaction will be possible should any problem arise with regard to the transfer of a payment; and}}
\textit{\textbf{- The need to split liquidity among several payments systems during the day can be avoided.}}

It is clear that by using an RTGS system, the results in terms of cost saving by some means will add profit for the users.

6. Cost of the RTGS system: liquidity requirements

Intraday liquidity requirements raise important issues for both the central bank and the private sector. Central banks, for their part, face a choice of whether or not to provide banks with intraday liquidity and if so, what form will that provision take (e.g., by what mechanisms and on what terms will the credit be provided and how will any resulting exposures be managed). Each central bank has its own policy standpoints to decide a mechanism to provide liquidity for their participants, but generally the central banks have similar rules and procedures to implement it.\textsuperscript{105}

From the perspective of individual banks, intraday liquidity requirements can lead to concerns about the associated costs. The author argues that usually there will be other related costs, which may include interest paid or fees on central bank credit or opportunity costs of tying up collateral or securities.

The intraday liquidity requirements under an RTGS system depend critically on:\textsuperscript{106}

\textsuperscript{104}Wilhelmina, Op.cit., pp.27.
\textsuperscript{105}The rules and procedures are referring to BIS Core Principles (CP-SIPS) and Financial Market Infrastructures (FMI).
“(a) the structure of the financial markets and systems (e.g., the adequacy of private sector sources of liquidity, the amount of collateral/securities available, reserve requirements); and
(b) the central bank’s policy regarding the provision of intraday credit. The means by which intraday liquidity is provided can significantly affect the extent to which immediate, or at least timely, final settlement occurs.
Ultimately, it can influence the balance between the potential benefits and costs of RTGS systems.”

One important thing that should be well considered is that the RTGS, as a high value payment system, must have no credit risk. In this case, the RTGS or LVPS must be categorized as a Systemically Important Payment System (SIPS). Why? Because the safety and efficiency of payment systems in the RTGS are significantly important for the effective functioning of the financial system. These SIPS principles will be further discussed in the next sub chapter.

2.3 Core Principles for the Systemically Important Payment Systems (the CPSIPS-RTGS)

According to Kay Barvell, in the late 1980s, the central bank governors of the G-10 countries expressed their concerns about issues involved in cross-border payments. The G-10 decided to create a study group that published a report in 1990, which analysed issues affecting cross-border and multi-currency payment netting schemes. The G-10 also decided to create the Committee on Payment and Settlement System (CPSS) and a secretariat under the auspices of the Bank for International Settlements (BIS), in Basel, Switzerland.

The BIS has provided guidelines to encourage the design and operation for the safety and efficiency of the systemically important payment systems worldwide. CPSS has published a report addressed to all central banks and other interested public sector agencies, plus all private sectors and operators of payment system. This publication, called the Core Principles for Systemically Important Payment Systems (CP-SIPS), consists of ten

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107Based on the rule of game: “No Money No Game”.
108The Group of Ten is made up of eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) which consult and co-operate on economic, monetary and financial matters.
110Ibid, Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries, BIS, November 1990. G-10 consists of, Belgium, Canada, France, Germany, Italy, Netherlands, Sweden, Switzerland, United Kingdom, and United States.
111SIPS is for a payment system which have the characteristic that a failure of this system may cause potentially jeopardize of the operation of the whole economy.
principles that should be complied with by all systemically important payment systems. These principles become a guideline for the oversight of those payment systems that are categorized as systemically important payment systems.

The report also explains the key role of central banks and sets out their responsibilities in applying the core principles. The author summarizes these ten core principles for systemically important payment systems (CPSIPS) based on the BIS report below:

I. **The system should have a well-founded legal basis under all relevant jurisdictions.**

   It means that the rules and procedures of a system should be transparent, comprehensible and enforceable. In this regard, not only are safety and efficiency the objectives of payment systems, but customer protection and competitive policy also play a role in this system. The regulations can also be relevant for other jurisdictions. This should be considered for cross-border transactions.

II. **The system’s rules and procedures should enable participants to have a clear understanding of the system’s impact on each of the financial risks they incur through participation in it.**

   This means that all parties involved in this system should be provided with explanatory substance to be able to clearly understand their financial risks.

III. **The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.**

   Under this principle, the mechanism for addressing the financial risks must be clear and understandable by all parties. Then, the rules and procedures of this system must be acknowledged by all parties and the procedures should, therefore ensure that the parties have the capabilities to manage each of the pertaining risks.

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112 Committee on Payment and Settlement Systems, “Core Principles for Systemically Important Payment Systems”, Bank for International Settlements Information, Press & Library Services, 2001 (CPSS, 2001). These principles are already replaced by the Principles for Financial Market Infrastructure (FMI’s, 2012), which require more detailed guidance and widening the scope of the standards to conceal new risk-management parts and recent categories of FMIs. The author puts these principles in order to make the readers easier to compare the new principles (FMI’s).


115 This principle becomes one of the reasons for the author to consider why the RTGS should be implemented and why it will be beneficial for the ASEAN members when facing the AEC 2015. The most important thing is, it should be stood on a proper legal basis for smoothing the payment system.
IV. **The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.**

This principle explains that the final statement must occur at the end of the day of value. Thus, the intraday liquidity mechanism is necessary for this condition to ensure prompt and final settlement.

V. **A system, in which multilateral netting takes place, should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.**

This principle means that netting settlements need strong controls in order to address this settlement risk. This netting system should comply with the Lamfalussy Standard IV, which specifies that a netting system must, at a minimum, be able to withstand the failure of the largest single net debtor to the system. This principle is not relevant to the real-time gross settlement system that we discuss.

VI. **Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk.**

This principle describes that the settlement asset must be transferable when the liquidity risk arises. Balances at the central bank are generally the most satisfactory assets used for settlement, because of the lack of credit or liquidity risk for the holder, and they are typically used in systemically important payment systems. Other assets that may be used must carry little or no financial risk.

VII. **The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.**

This principle is dealing not only with security and technology but also with the competent personnel who operates the system safely and efficiently, and ensures that the correct procedures are followed. The degree of security and reliability require an adequate safety and efficiency depends on the importance of the system as well as any other relevant factors, such as alternative arrangements for making payments in contingency situations.

VIII. **The system should provide a means of making payments, which is practical for its users and efficient for the economy.**

This principle is related to the design and operation of the system, which needs to consider how to provide a given quality of service in terms of functionality, safety and efficiency at a minimum resource cost. The design of the payment systems should, therefore, be appropriate for the country’s geography, population, and its infrastructure, such as telecommunications, transportation and banking structure. A particular design or technological solution that is suitable for one country may not be right for another. It should be designed and operated to adapt the developments of the
market for payment services both domestically and internationally. Their technical, business and governance arrangements should be sufficiently flexible to respond to the changing demands, for example, in adopting new technologies and procedures.

IX. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.

The rationale behind this principle is that all access criteria should be stated explicitly and disclosed to interested parties. This advantage may need to be weighed against the need to protect systems and their participants from the participation of institutions which would expose them to excessive legal, financial, and operational risks.

X. The system’s governance arrangements should be effective, accountable and transparent.

This principle describes the role of the central banks in providing the payment system’s governance, which encompass the relationships between the payment system’s management, on the one hand, and its governing body, its owners and its other stakeholders, on the other hand. This should be arranged because SIPS have the potential to affect the wider financial and economic community, hence, there is a particular need for effective, accountable and transparent governance, no matter whether the system is owned by central bank or by the private sector.

All central banks have responsibility in applying the CPSIPS by conducting what is known as self-assessment as part of oversight, and then this assessment is undertaken by the International Monetary Fund (IMF) and the World Bank. This whole process is called Financial Sector Assessment Program (FSAP). All the RTGS should comply with these 10 CPs in pursuing the objectives of safety and efficiency.

2.4 Principles for Financial Market Infrastructure (FMI)

The financial crisis in 2007 has prompted the important actors, i.e. firms and officials such as regulatory agencies on the financial markets, to seek a guarantee on the safe operation of financial markets and to protect investors and customers. The extreme volatility in the markets has both increased worries that the market infrastructure institutions central to the operation of financial systems may fail, and also increased pressures for trading, clearing and settlement to be centralized on precisely such institutions.\(^{116}\)

In US, the Federal Reserve Bank of New York formed the payment risk committee, which consists of a private sector group of several major banks. The committee published the

report of the Financial Market Infrastructure (FMI) Risk in May 2007.\textsuperscript{117} The committee identifies and analyses issues of mutual interest related to the risk in payment and settlement systems. The task force has developed 10 recommendations for sound management practices for banks to consider and apply as appropriate within their institution. The author further elaborates the recommendations as follows:\textsuperscript{118}

1. A bank should have documented its risk practices and policies for addressing its memberships and transactions with the FMI identifying responsibilities for assessing, approving, reporting and managing the risks. It means that banks should have a good documentation and administration of risks in order to have a better understanding and identifying of the system’s impact related to the financial risks;

2. A bank should conduct the appropriate level of due diligence in analysing and approving the risks of being a member of or transacting with an FMI. This is related to the understanding of the management to define and specify its responsibilities to manage the risks;

3. A bank should have a clear understanding and reporting of any membership-related credit risks and exposures to an FMI. This includes loss-sharing of the financial obligations to cover the default of another member and direct credit risks to an FMI, which serves as a central counterparty to trades/transactions. This means that banks should understand the system’s procedures to manage credit risks and liquidity risks related to the default of other members.

4. A bank should have a clear understanding of any material operational risks that it takes as a member of or a counterparty of an FMI. A bank should consider the need to perform periodic assessments (on-site or via inquiry) of the FMI’s operations where the bank conducts significant activity. A bank should have a good understanding on rules and procedures of the operational system, including monitoring and assessing that system.

5. A bank should have a clear understanding of any material legal risks that it assumes as a member of an FMI. An analysis should be conducted when a bank first joins an FMI and it should identify and assess any undue contractual liability, the lack of legal support for key activities of the FMI (e.g., finality, netting, collateral rights), and any important/undue compliance requirements. A bank should have practices and policies in place to ensure that its understanding of any of its material risks to an FMI is current. This includes monitoring and assessing the material developments of an FMI and/or

\textsuperscript{118}Ibid.
performing periodic risk assessments. This relates to the rules and procedures for operating a system.

6. A bank should have practices and policies in place to ensure that is understanding of any of its material risks to an FMI is current. This includes monitoring and assessing material developments at an FMI and/or performing periodic risk assessments. This is about the rules and procedures for operating a system.

7. A bank should require appropriate level management review of participation in the choice of FMIs that present material adverse risks, such as exposure to open-ended liability. This relates to the quality of management in administering the risk exposure when joining the system.

8. A bank should establish a framework for mitigating risks to FMIs as appropriate. This includes, but is not limited to, negotiating contractual provisions, using a small capitalized subsidiary as the member to limit liability, setting transaction/trading limits, accessing the FMI indirectly via a correspondent, or via active governance by serving on boards, industry groups, committees, etc. This is related to having rules and procedures for mitigating risks.

9. A bank should ensure that its own continuity of business planning takes into account operation failures at major FMIs. A bank should have a business continuity plan and a disaster recovery plan in order to face the operation failures of the system.

10. A bank should consider whether having a centralized risk management approach to FMI risk where a small risk management staff specializes in bank-wide FMI risk analysis and performs portfolio level monitoring and reporting -- is a more effective and efficient way to manage the ongoing risks with FMIs than through a decentralized approach. A bank should have a centralized control management in order to manage risks.

Furthermore, in 2012, the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) have made new standards, called “principles” for facilitating the clearing and settlement of monetary and other financial transactions.119 These principles are designed to ensure that the infrastructure supporting global financial markets is more robust and thus well placed to withstand financial shocks.120 These principles are regularly updated.121 The author observes that this FMI is more comprehensive and accustomed to the current conditions than CPSIPS.

121 Ibid.
As mentioned above-, FMIs play a critical role in the guideline of oversight of the financial system and the broader economy. These FMIs have 24 principles and for the purposes of this report, an FMI refers to payment systems, Central Securities Depositories (CSDs), Securities Settlement Systems (SSSs), Central Counterparties (CCPs), and Trade Repositories (TRs). They replace the existing set of international standards set out in the Core Principles for Systemically Important Payment Systems (CPSS, 2001). The main public policy objectives of the CPSS and the Technical Committee of IOSCO in setting forth these principles for FMIs are to enhance safety and efficiency in payment, clearing, settlement, and recording arrangements, and more broadly, to limit systemic risk and foster transparency and financial stability.

With regard to the risks, FMIs allow participants to manage their risks more effectively and efficiently, and, in some cases to reduce or eliminate certain risks. There are specific key risks delivered by FMIs: systemic, legal, credit, liquidity, general business, custody and investment, and lastly, operational risks.

The principles focus on risks and efficiency. There are a few exceptions: they do not recommend a specific instrument or procedure to achieve their goals but they tolerate different means to satisfy a particular principle. Where appropriate, some principles establish a minimum requirement to help contain risks and to provide a level playing field. The principles are made to be applied completely because of the substantial collaboration between the principles; principles should be applied as a package and not on a stand-alone basis. Some principles connect to others and some complement each other. For instance, in handling financial risk of RTGS, one principle should allude to other related principles such as the principles on the framework for the comprehensive management of risks, credit risk, collateral, liquidity risk, settlement finality, money settlements, and exchange-of-value settlement systems. Other relevant principles such as legal basis, governance, participant-default rules and procedures, general business risk, custody and investment risks, and operational risk, are also important to be assessed. They complement to each other and also should be taken into account. Failure to apply all of these principles as a set may result in less than an adequate risk management. In addition, authorities have the flexibility to consider imposing higher requirements for these principles in their jurisdiction either on the basis of specific risks posed by an FMI or as a general policy.

122 Ibid. In some cases, exchanges or other market infrastructures may own or operate entities or functions that perform centralized clearing and settlement processes that are covered by the principles in the report. In general, however, the principles in this report are not addressed to market infrastructures such as trading exchanges, trade execution facilities, or multilateral trade-compression systems; nonetheless, relevant authorities may decide to apply some or all of these principles to types of infrastructures not formally covered by this report.

123 Ibid. These objectives are consistent with the public policy objectives of previous reports by the CPSS and the Technical Committee of IOSCO. Other objectives, which include anti-money laundering, antiterrorist financing, data privacy, promotion of competition policy, and specific types of investor and consumer protections, can play important roles in the design of such systems, but these issues are generally beyond the scope of this and previous reports.

124 Ibid.
This is a basic guideline for countries to implement the settlement of monetary and other financial transactions. These standards for FMIs are expected to be part of the body of international standards and codes recognized by international financial institutions.

From these FMI’s principles, most principles are relevant for the Systemically Important Payment Systems (SIPS). The author tries to sum up the FMI’s principles used for SIPS of High Value Transfer System (RTGS). The principles, which are published by BIS, are concise as follows:

a. **Principle 1: Legal Basis**

An FMI should have a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.

This means that an FMI should have rules, procedures, and contracts that are clear, understandable, and consistent with relevant domestic laws and regulations and also enforceable in all relevant jurisdictions. With regard to dispute, legal risk due to conflict of laws may arise if the FMI is subject to the laws of various other jurisdictions, for example, when transaction is conducted in multiple jurisdictions. In such case, the FMI should identify and examine potential conflict of laws issues and develop rules and procedures to mitigate this risk. In other words, the regulations governing its activities should clearly indicate the law that it intends to apply to each aspect of the FMI’s operations.

The FMI and its participants should be alert to relevant constraints on their abilities to choose the law that will govern such activities when there is a distinction in the substantive laws of the relevant jurisdictions. For example, such constraints may exist because of jurisdictions’ differing laws on insolvency and irrevocability. A jurisdiction ordinarily does not permit contractual choices of law that would circumvent that jurisdiction’s fundamental public policy. Thus, when uncertainty exists regarding the enforceability of an FMI’s choice of law in relevant jurisdictions, the FMI should obtain reasoned and independent legal opinions and analysis in order to address properly such uncertainty.

The FMI should be able to articulate its legal basis for such activities to relevant authorities, participants, and participants’ customers in a transparent and comprehensible means. A legal opinion or analysis should, to the extent practicable, confirm the enforceability of the FMI’s rules and procedures and must provide reasoned support for its conclusions. An FMI should consider sharing these legal

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125 From 24 principles, 18 principles cover the SIPS.
126 Some countries still consider the netting settlement is also SIPS. In this paper, the author only focusing the RTGS system is SIPS.
opinions and analyses with its participants in an effort to promote confidence among participants and transparency in the system.

b. Principle 2: Governance

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.

**This** principle states that an FMI should have documented governance arrangements that provide clear and direct lines of responsibility and accountability for all related parties which place high priority of safety and efficiency of the FMI. The governance in this principle also relates to the management of the FMI, which needs to be highly skilled and experienced. Also should be taken into account of their accountability, transparency, and independency.

c. Principle 3: Framework for the comprehensive management of risks

An FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.

An FMI should have a good risk-management framework, i.e. policies and procedures, which enable to identify, measure, monitor, and manage the range of risks that arise in or are borne by the FMI. The risk-management framework should be subject to periodic review.

An FMI’s framework should include the identification and management of interdependencies. An FMI should also provide appropriate incentives as well as proper information for its participants and other entities to manage and contain their risks in relation to the FMI.

d. Principle 4: Credit risks

An FMI should effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In addition, a CCP that is involved in activities with a more-complex risk profile or that is systemically important in multiple jurisdictions should maintain sufficient additional financial resources to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions. All other CCPs should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited
to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions.

Credit risk is broadly defined as the risk that a counterparty will be unable to meet fully its financial obligations when due or at any time in the future. The default of a participant (and its affiliates) has the potential to cause severe disruptions to an FMI, its other participants, and, more broadly, financial markets. Therefore, an FMI should establish a robust framework to manage its credit exposures to its participants and the credit risks arising from its payment, clearing, and settlement processes.

A payment system may face credit risk from its participants, its payment and settlement processes, or both. This credit risk is driven mainly by current exposures from extending intraday credit to participants. The type and level of credit exposure faced by an FMI will vary based on its design and the credit risk of the counterparties concerned.

e. Principle 5: Collateral

An FMI that requires collateral to manage its or its participants’ credit exposure should accept collateral with low credit, liquidity, and market risks. An FMI should also set and enforce appropriately conservative haircuts and concentration limits.

An FMI should use a collateral management system that is well designed and operationally flexible. The use of collateral can provide participants with incentives to manage the risks they pose to the FMI or other participants. An FMI that accepts collateral with credit, liquidity, and market risks above minimum levels should demonstrate that it sets and enforces appropriately conservative haircuts and concentration limits. However, an FMI should regularly adjust its requirements for acceptable collateral in accordance with changes in the underlying risks.

If an FMI accepts a cross-border (or foreign) collateral, it should identify and mitigate any additional risks associated with its use and ensure that it can be used in a timely

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128 Ibid., pp.38.
129 Ibid. An affiliate is defined as a company that controls, is controlled by, or is under common control with the participant. Control of a company is defined as (a) ownership, control, or holding with power to vote 20 percent or more of a class of voting securities of the company; or (b) consolidation of the company for financial reporting purposes.
130 Ibid. Many payment systems do not face credit risk from their participants or payment and settlement processes, although they may face significant liquidity risk.
131 Ibid. In considering its credit exposure to a central bank, on a case-by-case basis, the FMI may take into account the special characteristics of the central bank.
132 Ibid. In general, guarantees are not acceptable collateral. However, in rare circumstances and subject to regulatory approval, a guarantee fully backed by collateral that is realizable on a same-day basis may serve as acceptable collateral. An explicit guarantee from the relevant central bank of issue would constitute acceptable collateral providing it is supported by the legal framework applicable to and the policies of the central bank.
manner. An FMI also should consider the foreign-exchange risk where the collateral is denominated in a currency different from that in which the exposure arises, and set haircuts to address the additional risk to a high level of confidence.

f. Principle 7: Liquidity risk

An FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions.

An FMI should have a robust framework to manage its liquidity risks from the full range of participants and other entities. An FMI should also regularly assess its design and operations to manage liquidity risk in the system. For the purpose of meeting its minimum liquid resource requirement, an FMI’s qualifying liquid resources in each currency include cash at the central bank of issue and at creditworthy commercial banks, committed lines of credit, committed foreign exchange swaps, and committed repos, as well as highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions.

g. Principle 8: Settlement Finality

An FMI should provide clear and certain final settlement, at a minimum by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.

An FMI should be designed to provide clear and certain final settlement of payments, transfer instructions, or other obligations. An FMI’s rules and procedures should clearly define the point at which settlement is final and the system should complete final settlement no later than the end of the value date, and preferably intraday or in real time, in order to reduce settlement risk.

An FMI should take reasonable steps to confirm the effectiveness of cross-border recognition and the protection of cross-system settlement finality, especially when it is

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133 Cross-border collateral has at least one of the following foreign attributes: (a) the currency of denomination, (b) the jurisdiction in which the assets are located, or (c) the jurisdiction in which the issuer is established.

134 Other entities are parties which are associated to the FMI, such as its settlement banks, nostro agents, custodian banks, and liquidity providers.

135 Final settlement is defined as the irrevocable and unconditional transfer of an asset or financial instrument, or the discharge of an obligation by the FMI or its participants in accordance with the terms of the underlying contract.
developing plans for recovery or orderly wind-down or providing relevant authorities information relating to its resolvability. Because of the complexity of legal frameworks and system rules, particularly in the context of cross-border settlement where legal frameworks are not harmonized, a well-reasoned legal opinion is generally necessary to establish the point at which finality takes place.

**h. Principle 9: Money Settlement**

An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money.

It is clear that an FMI can use central bank money or commercial bank money. There is a model that an FMI typically establishes an account with one or more commercial settlement banks and requires each of its participants to establish an account with one of them. In some cases, the FMI itself can serve as the settlement bank. Money settlements are then effected through accounts on the books of the FMI, which may need to be funded and defunded. An FMI may also use a combination of central bank and commercial bank monies to conduct settlements, for example, by using central bank money for funding and defunding activities and using commercial bank money for the settlement of individual payment obligations.

**i. Principle 12: Exchange-of-Value Settlement systems**

If an FMI settles transactions that involve the settlement of two linked obligations (for example, securities or foreign exchange transactions), it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other.

The settlement of a financial transaction by an FMI may involve the settlement of two linked obligations, such as the delivery of securities against payment of cash or securities or the delivery of one currency against delivery of another currency. In this context, a principal risk may be created when one obligation is settled, but the other obligation is not (for example, the securities are delivered but no cash payment is received). Because this principal risk involves the full value of the transaction, substantial credit losses as well as substantial liquidity pressures may result from the...
default of counterparty or, more generally, the failure to complete the settlement of both linked obligations.

An FMI that is an exchange-of-value settlement system should eliminate the principal risk by linking the final settlement of one obligation to the final settlement of the other through an appropriate DvP, DvD, or PvP settlement mechanism. DvP, DvD, and PvP settlement mechanisms eliminate the principal risk by ensuring that the final settlement of one obligation occurs if and only if the final settlement of the linked obligation occurs.

**j. Principle 13: Participant-Default Rules and Procedures**

*An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures and continue to meet its obligations.*

An FMI should have default rules and procedures that enable the FMI to continue to meet its obligations in the event of a participant default and that address the replenishment of resources following a default.

Participant-default rules and procedures facilitate the continued functioning of an FMI in the event that a participant fails to meet its obligations. These rules and procedures help limit the potential for the effects of a participant’s failure to spread to other participants and undermine the viability of the FMI. The key objectives of the default rules and procedures should include (a) ensuring timely completion of settlement, even in extreme but plausible market conditions; (b) minimizing losses for the FMI and for non-defaulting participants; (c) limiting disruptions to the market; (d) providing a clear framework for accessing FMI liquidity facilities when needed; and (e) managing and closing out the defaulting participant’s positions and liquidating any applicable collateral in a prudent and orderly manner.

**k. Principle 15: General Business Risk**

*An FMI should identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialize. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.*

An FMI should have robust management and control systems to identify, monitor, and manage general business risks, including losses from poor execution of business strategy, negative cash flows, or unexpected and excessively large operating expenses. General business risk refers to the risks and potential losses arising from an FMI’s
administration and operation as a business enterprise that are neither related to participant default nor separately covered by financial resources under the credit or liquidity risk principles.

An FMI should maintain a viable recovery or orderly wind-down plan and should hold sufficient liquid net assets funded by equity to implement this plan. At a minimum, an FMI should hold liquid net assets funded by equity equal to at least six months of current operating expenses. An FMI should hold liquid net assets funded by equity (such as common stock, disclosed reserves, or retained earnings) so that it can continue operations and services as a going concern if it incurs general business losses.\textsuperscript{138}

l. Principle 16: Custody and Investment Risks

An FMI should safeguard its own and its participants’ assets and minimize the risk of loss on and delay in access to these assets. An FMI’s investments should be in instruments with minimal credit, market, and liquidity risks.

An FMI should hold its own and its participants’ assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets. An FMI should have prompt access to its assets and the assets provided by participants, when required. An FMI should evaluate and understand its exposures to its custodian banks, taking into account the full scope of its relationships with each of them.

m. Principle 17: Operational Risk

An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the FMI’s obligations, including in the event of a wide-scale or major disruption.

An FMI should establish a robust operational risk-management framework with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks.\textsuperscript{139} An FMI’s board of directors should clearly define the

\textsuperscript{138}If the FMI’s corporate structure is such that it cannot legally or institutionally raise equity (for example under certain structures of mutual ownership or when the FMI is run by a central bank) or if the FMI is a new start-up and cannot initially raise the required level of equity, it should ensure an equal amount of equivalent loss absorbing financial resources is available.

\textsuperscript{139}Operational risk is the risk that deficiencies in information systems, internal processes, and personnel or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by an FMI.
roles and responsibilities for addressing operational risk and should endorse the FMI’s operational risk-management framework. Systems, operational policies, procedures, and controls should be reviewed, audited, and tested periodically and after significant changes.

An FMI should have a business continuity plan that addresses events posing a significant risk of disrupting operations, including events that could cause a wide-scale or major disruption. The plan should incorporate the use of a secondary site and should be designed to ensure that critical information technology (IT) systems can resume operations within two hours following disruptive events. The plan should be designed to enable the FMI to complete settlement by the end of the day of the disruption, even in case of extreme circumstances. The FMI should regularly test these arrangements.

An FMI should identify, monitor, and manage the risks that key participants, other FMIs, and service and utility providers might pose to its operations. In addition, an FMI should identify, monitor, and manage the risks its operations might pose to other FMIs.

n. Principle 18: Access and Participation Requirements

An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

An FMI should allow for fair and open access to its services, including by direct and, where relevant, indirect participants and other FMIs, based on reasonable risk-related participation requirements.

An FMI should always consider the risks that an actual or prospective participant may pose to the FMI and other participants. Accordingly, an FMI should establish risk-related participation requirements adequate to ensure that its participants meet appropriate operational, financial, and legal requirements to allow them to fulfil their obligations to the FMI, including the other participants, on a timely basis. For participants, act for other entities (indirect participants), it may be appropriate for the FMI to impose additional requirements to ensure that the direct participants have the capacity to do so.

o. Principle 19: Tiered Participation Arrangements

An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.

An FMI should ensure that its rules, procedures, and agreements allow it to gather basic information about indirect participation in order to identify, monitor, and manage any material risks to the FMI arising from such tiered participation.
An FMI should identify material dependencies between direct and indirect participants that might affect the FMI.

An FMI should identify indirect participants responsible for a significant proportion of transactions processed by the FMI and indirect participants whose transaction volumes or values are large relative to the capacity of the direct participants through which they access the FMI in order to manage the risks arising from these transactions. An FMI should regularly review risks arising from tiered participation arrangements and should take mitigating action when appropriate.

p. Principle 21: Efficiency and Effectiveness

An FMI should be efficient and effective in meeting the requirements of its participants and the markets it serves.

An FMI is not only should be efficient and effective in meeting the requirements of its participants and the markets it serves, but also should be maintaining appropriate standards of safety and security as outlined in the principles in this report.

One mechanism which an FMI’s design and operation might use to gauge its success in meeting the needs of its participants and the markets it serves are periodic satisfaction surveys of its participants and other relevant institutions in the market.

q. Principle 22: Communication Procedures and Standards

An FMI should use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement, and recording.

An FMI’s adoption of internationally accepted communication procedures and standards for its core functions can facilitate the elimination of manual intervention in clearing and settlement processing, reduce risks and transaction costs, improve efficiency, and reduce barriers to entry into a market.

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140 Tiered participation arrangements occur when some firms (indirect participants) rely on the services provided by other firms (direct participants) to use the FMI’s central payment, clearing, settlement, or recording facilities. For the purposes of this principle, an FMI can have two types of relationships that affect tiered participation arrangements. The first type of relationship is with participants in the FMI that are bound by the FMI’s rules and agreements. Such “direct participants” and the management of the risks they present should be fully covered by the rules and agreements of the FMI and are generally dealt with in other principles in this report. The second type of relationship is with entities that are not bound by the rules of the FMI, but whose transactions are cleared, settled, or recorded by or through the FMI. These entities are defined as “indirect participants” in the FMI in this principle.

141 Efficiency” refers generally to the resources required by the FMI to perform its functions, while “effectiveness” refers to whether the FMI is meeting its intended goals and objectives.

142 There may be different ways for an FMI to meet a particular principle, but the objective of a particular principle should not be compromised.
With regard to cross-border transactions, an FMI that settles a chain of transactions processed through multiple FMI s or provides services to users in multiple jurisdictions, should strongly consider using internationally accepted communication procedures and standards to achieve efficient and effective cross-border financial communication. Moreover, implementing these communication procedures can facilitate interoperability between the information systems or operating platforms of FMI s in different jurisdictions, which enable market participants to acquire access to multiple FMI s without facing technical obstacles (such as having to implement or support multiple local networks with different characteristics).

r. Principle 23: Disclosure of Rules, Key Procedures and Market Data

An FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be publicly disclosed.

An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to the participants. Relevant rules and key procedures should also be publicly disclosed. An FMI should disclose clear descriptions of the system’s design and operations, as well as the FMI’s and participants’ rights and obligations, so that participants can assess the risks they would incur by participating in the FMI.

An FMI should provide all necessary and appropriate documentation and training to ease participants’ understanding of the FMI’s rules and procedures and the risks they will face when participating in the FMI. An FMI should publicly disclose its fees at the level of individual services, as well as its policies on any available discounts. The FMI should provide clear descriptions of priced services for comparability purposes.

An FMI should regularly complete and publicly disclose responses to the CPSS-IOSCO Disclosure framework for financial market infrastructures. An FMI also should, at a minimum, disclose basic data on transaction volumes and values.

Generally, there are not much differences between 10 CPSIPS and 24 FMI s for the RTGS system. From the above descriptions, again, it is clear that the FMI s provide more detailed guidance and broaden the scope of the standards to cover new risks management area, such as, exchange-of-value settlement systems, general business risk, and tiered participation arrangements, which standards are implicitly covered in 10 CPSIPS. The new standard seems to emphasize that all aspects are important and need to be assessed and taken into account according to the new circumstances.

In certain extreme atmospheres, all precautionary measures are very important. Failure or disorder in a payment system, in this case, RTGS, would potentially lead to systemic disruptions to the related institutions and markets. This would also result in a
negative implication to any other FMI to which the failing FMI is linked and would impact the financial system in general.

With regard to the possibility of integrating all RTGS systems among the ASEAN members, the principle of exchange-of-value settlement systems is an important one to be considered. Since these PFMIs were just published in April 2012, these should be taken into consideration by all members in order to prepare for the integration of payment system in ASEAN.

### 2.5 Assessment of RTGS in ASEAN and the EU

The Financial Sector Assessment Program (FSAP), launched in 1999, is a wide-ranging and comprehensive assessment of a country’s financial sector.\(^{143}\) It is a key instrument of the Fund’s surveillance and provides input to the Article IV consultation.\(^{144}\) These assessments include two components: a financial stability assessment, which is the responsibility of the IMF, and a financial development assessment, which is the responsibility of the World Bank.\(^{145}\)

Since the 10 Core Principles for Systemically Important Payment Systems (CP-SIPS) was published in 2001, most of the ASEAN members and the EU members have participated in The FSAP.\(^{146}\) These CPSIPS is part of the whole assessment of financial sectors. Four standards and codes were assessed in FSAP according to the IMF Report on Indonesia in 2010, namely:\(^{147}\) (i) Banking Industry - Basel Core Principles (BCP); (ii) Securities - International Organization of Securities Commissions Principles of Securities Regulation (IOSCO) (iii) Payment System (RTGS) - Core Principles for Systemically Important Payment Systems (CPSIPS); and (iv) Monetary Policy Transparency (MPT).

In this dissertation, the author would like to describe the result of the FSAP assessment on payment systems based on IMF Country report from several of the ASEAN members and the European Union members.

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\(^{143}\)The assessment has been developed to assist countries to identify and manage weaknesses in their financial sector structure. Thus, it improves their resilience to macroeconomic shocks and cross-border negative impact.


\(^{145}\)Ibid.

\(^{146}\)These assessments are mandatory for financial sectors which deemed by the Fund to be systemically important, based on part of Article IV surveillance, and are supposed to take place every five years. The publication itself is voluntarily, so ASEAN members’ reports are not all published.

2.5.1 RTGS Assessment in ASEAN

- The FSAP summary report on Indonesia (2010 and 2012) states that:  

  “Indonesia recovered quickly after being hit hard by contagion from the global financial but still faces challenges to preserve the financial stability and develop its financial system. The challenges that have to handles are the weaknesses in the legal and governance framework undermine the investor confidence. More fundamentally, the most critical gap in the oversight of the financial system is the absence of legal protection for the financial sector regulator and supervisor.”

With regard to the payment systems, since 1999, Bank Indonesia (BI) has become an independent institution, thus its monetary policy and payment system policy cannot be influenced by any parties, including the government. BI considers BI-RTGS system to be the only systemically important payment system (SIPS) in the country, although there are several systems in operation in Indonesia. The payment system has been empowered by BI Act 23 of 1999, 149 to oversee, regulate and impose sanctions on the payments system, meaning that BI holds the authority in payment system. A number of statutes have been enacted, supported by regulations and circular letters issued by BI from time to time. 150 The authorities should however consider enacting a specific law that governs payment systems and also should address any areas that need further strengthening and clarity. 151 BI-RTGS is owned and operated by Bank Indonesia (BI). BI-RTGS has a contractual arrangement between BI and participants and has a code of conduct amongst the participants codified in a bylaw. 152

In general, the RTGS system is observed and has complied with the 10 CP-SIPS. There are several issues that need to be noted. For example, when considering the enactment of a specific law that governs payment systems, it should be noted that the process of enacting acts needs time and involves many parties and it should be considered that the extending its oversight to the operational of the securities settlement system which is still under other authorities i.e. Bapepam-LK and Ministry of Information and Communication, which BI does not have an authority to regulate and oversee it. BI already designed the next generation RTGS, called BI-RTGS 2 generation.

149 Act No.23 of 1999 concerning Bank Indonesia in chapter III, Article 8(b) and chapter V Articles 15-23.
151 Ibid.
152 The BI-RTGS bye-law is a rule of game made by the bank association’s members to regulate themselves, concerning technical matters.
The summary FSAP report on Singapore (2004) states that:

“Singapore’s financial sector, which is dominated by the banking sector, remains robust despite a series of economic downturns and substantial asset price declines. Economic developments in the past few years have highlighted Singapore’s vulnerability to exogenous shocks, including the outbreak of Severe Acute Respiratory Syndrome (SARS). The Monetary Authority of Singapore (MAS) should more closely monitor to enhance the MAS early warning capabilities on the financial linkages of the global financial system, include local banks’ operations overseas and in the Asian Dollar Market. Systemic liquidity is well managed and regulatory and supervisory practices exhibit a high degree of observance of international standards and codes across all segments of the financial sector. MAS need a further deepening of the corporate bond market would help diversify funding sources for the corporate sector.”

With regard to the payment system, Singapore has a technologically advanced payment system for both retail payments and large value payments. Singapore has MAS Electronic Payment System (MEPS) for interbank payment transfers, and also for the settlement of multilateral netting of cheques and interbank Giro retail transfers and the settlement of SGS on delivery versus payment basis. The report stated that the legal basis of MEPS is well founded and supported by Section 29A of the MAS Act and on the Payment and Settlement Systems (Finality and Netting) Act.

In relation to the management of risks, the Monetary Authority of Singapore (MAS) has the rules and procedures, which indicates that MEPS is an RTGS system where each settled transfer is final and irrevocable. MAS had a goal to upgrade the system to a so-called MEPS+. MEPS+ also provides prompt and final settlement during the day. MEPS+ settles in central bank money, thus participants are not exposed to settlement bank risks.

MEPS also has contingency measures and offers an efficient set of functional facilities, such as introducing the SWIFT standard message types. The access is open for all banks, excluding merchant banks, and has broadened so that the CDP Securities Settlement systems can become members of the SGX-ST in the central bank money.

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Overall, Singapore already complied with 10 CPSIPS, but there is a recommendation related to MEPS that needs to be followed i.e. to amend Singapore’s law related to collateralized loan in the form of repos, when an automatic intraday liquidity facility will be introduced in MEPS.\(^{155}\)

- The summary FSAP report on Thailand (2009) states that:\(^{156}\)

  “The soundness of Thailand’s financial system has been strengthened since the financial crisis of the late 1990s. Banking fundamentals have strengthened, with most Thailand banks reporting high levels of capital and solid profitability. Notwithstanding these improvements, policymakers face several critical challenges to further enhance the stability and efficiency of the financial system such as need for continued and close supervisory attention to weaker banks, address remaining legacy problems associated with the financial crisis, particularly reducing the high level of NPL and NPA in the financial system.”

In relation to the payment system, Thailand has no explicit legislation for such payment systems. However, the legal basis for BAHTNET and payment transfers executed in this system is defined by a set of laws, regulations, and contractual arrangements.\(^{157}\) Bank of Thailand (BOT) has BATHNET for interbank payments and for the settlement of interbank obligations of the net clearing arrangements of the low-value payment transactions and those equities transactions. BAHTNET also settles the cash leg of the transactions in government bonds deposited at Thailand Securities Depository Co., Ltd. (TSD) on a real time gross basis.

Generally, based on the IMF report, BOT has complied with the 10 CPSIPS but there are several recommendations to be followed-up. BOT needs to revise the BOT act, which would provide more transparency and details in the field of

\(^{155}\)\textit{Ibid}


\(^{157}\)The regulations that are important related to the payment system has spread out in several acts and contracts such as The Bank of Thailand Act, B.E. 2485 (1942) stipulates the roles of the BOT in issuing, managing, and printing of notes and bank notes; and the management of the country’s reserves; The Royal Decree Regulating the Affairs of the Bank of Thailand B.E. 2485 (1942) authorizes the BOT to administrate interbank clearing systems; The Commercial Banking Act, B.E. 2505 (1962) empowers BOT to directly supervise commercial banks and local foreign bank branches; The Currency Act, B.E. 2501 (1958) governs issue and management of banknotes; The Civil and Commercial Code, B.E. 2468 (1925) covers other financial papers used as means of payments such as checks, bills of exchange, and promissory notes (the Law relating to Legal instruments, Contracts and Obligations); The Securities and Exchange Act, B.E. 2535 (1992) regulates securities business and securities market infrastructure; The Electronic Transaction Act, B.E. 2544 (2001) provides the legal recognition of electronic data messages intended for promoting the reliability of electronic transactions; Consumer Protection Law, B.E. 2522 (1979) provides consumer protection, including payment transactions; and The Bankruptcy Act, B.E. 2483 (1940) governs insolvency and bankruptcy issues, including the liquidation of financial institutions as well as branches or agencies of foreign banks.
payment systems. BOT should eliminate the risks of settlement finality in the event of insolvency, where the payment transaction still can be revoked in BAHTNET system, by amending the Bankruptcy law. Oversight responsibility should be strengthened by BOT in coordination with SEC. BAHTNET should also review and audit in the contingency plan test and set up a permanent advisory group that meets on a regular basis to discuss issues related to technical and business features of BAHTNET.

- Based on the summary of the IMF report on the Philippines (2005), the report stated that the Bangko Sentral ng Pilipinas (BSP), clearing house and major banks play significant roles in the Philippines payment systems. The IMF identified the Systemically Important Payment Systems (SIPS) in the Philippines as Multi-transactions Interbank Payment System (MIPS2), cheque clearing and the Philippine Domestic Dollar Transfer System (PDDTS-U.S. dollar) gross systems. The Philippines has the legal and regulatory framework for the establishment of interbank clearing facilities, but the finality of settlement for both public and private systems is concluded through contractual obligations and it does not have as strong a legal basis as compared to a central bank law. This may tie the enforceability to the judicial processes, which may complicate the effectiveness of systemic risk reduction. There is also vagueness regarding the oversight responsibilities and the central bank power over the payment system operators such as the Philippine Clearing House Corporation (PCHC) and the Philippine Central Depository (PCD), particularly the PDDTS which is facilitated by the private sector. This may pose some risks not only on the cheque clearing but also on inter-regional clearing. The offsite back up facilities need to be improved to strengthen the security and operational reliability of MIPS2 and the cheque clearing systems. The general criteria for participants are not explicit. There are no anti-competitive practices or methods that might compromise the safety, fairness and efficiency within the systems.

- Based on the summary FSAP report on Malaysia (2013), the IMF stated that there was a clear distinction of oversight, regulatory and supervision jurisdiction between the Securities Commission and the Bank Negara Malaysia (BNM). The BNM is responsible for the oversight of the payment systems and settlement

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systems for unlisted government, and private debt securities. The BNM has RENTAS which functions as a Real-Time Gross Settlement System, which is also integrated with a CSD and also handles securities settlement of unlisted Government, and private debt securities. Regarding the legal basis, the legal framework explicitly provides for finality. However, the certainty of protection of collateral placed for liquidity support and protection of repo arrangements is not explicit. With regard to CSD, the segregation arrangements for the customers that have been provided for in the legal framework should be tested and the procedures for implementing portability should be verified as well.

It seems to the author that from these summary reports of the IMF, it is obvious that ASEAN, represented by these countries, in general already complies with the CP-SIPS. The RTGS systems of the relevant countries have strong legal basis, which binding to all the participants. Aside from a set of regulations, they have contractual agreements among the parties. They also have standards and procedures to run the RTGS system. With regard to the rules and procedures, the respective countries need to review their regulations accordingly and test the system periodically.

2.5.2 RTGS Assessment in the EU

The IMF and the World Bank have also assessed the RTGS system of the EU members as developed countries. The assessment also resulted in some recommendations from the IMF that are to be complied with. It is important to know, that in the EU there is an integrated payment system which is connected to all of the RTGS system in each of the EU members, called TARGET, so that the assessment is related to and have to comply with the TARGET rules. This TARGET system will be discussed further in the next chapter.

- The IMF report on Germany (2003). Germany has the largest banking sector, insurance and pension sector, and non-financial institution sector. The regulatory framework and financial sector supervision are of high quality.

With regard to the payment system, the report stated that the payment system is functioning well and does not give rise to any systemic vulnerability. The RTGS-

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160The legal framework for payment systems and government securities consists of (1) The Central Bank of Malaysia Act 2009 (CBA) that provides the mandate for Bank Negara Malaysia (BNM) to own and operate payment and settlement systems, and (2) The Payment System Act 2003 (PSA) that strengthens the payment and settlement systems oversight powers and firmly establishes the BNM as the authority which is responsible for promoting the reliable, efficient and smooth operation of the national payment and settlement systems.

161Except the Philippines which still uses contractual obligations for the finality settlement.

plus is connected to the European TARGET system. The assessment of the CPSS core principles for SIPS of RTGS-plus, operated by the Bundesbank, are fully observed.

This report indicated that Germany was well prepared for implementing the payment systems in complying with the CPSS core principles.

- The IMF report on France (2005).\textsuperscript{163} France fulfils all prerequisites for effective payment clearing and settlement systems. The legal framework is sound. France has French law and contractual agreements within the framework of Transferts Banque de France (TBF), the RTGS system, which provide a well-established and reasonably comprehensive legal basis for fund transfers. All relevant laws are fully enforceable. France’s payment systems need an improvement towards transparency in a problematic situation with respect to the behaviour of the participants. Such problems are technical failures of the platform or in case of bankruptcy of the participants. It also needs a handbook that could be made obtainable in which the pertinent topics would be more user-friendly and more practical. The overall assessments are generally observed.

- The IMF report on Italy (2004 and 2006).\textsuperscript{164} The Banca d’Italia RTGS System for Large-Value Payments (BIREL) has been in use for large-value interbank payments since 1997.\textsuperscript{165} The legal basis, the rules, guidelines, and other documents related to BIREL,\textsuperscript{166} and to its operating procedures, have to be set by the Banca d’Italia (BdI) within the constraints of the TARGET rules that have been issued by the European Central Bank (ECB), under Article 22 of its Statute.\textsuperscript{167} The procedures for


\textsuperscript{165}The authority of the BdI over payment systems and the legal basis of banking industry are based on the Italian Banking Law (IBL) 1993 and payment systems Oversight Provisions (OP) in 2004 issued by the Governor of the BdI. In Article 146 of IBL states: “Banca d’Italia shall promote the regular operation of payment systems. For this purpose, it may issue regulations to ensure the efficiency and reliability of clearing and payment systems.”

\textsuperscript{166}Since 2003 (during the assessment of IMF), BIREL has been replaced by the New BIREL.

operating and managing BIREL are clearly and publicly set out in the Italian legislation\textsuperscript{168}, within the context of the TARGET rules and guidelines.

With regard to the provisions that are specifically governing the BIREL system, the Governing Council has drawn up the guidelines for the TARGET system which are to be applied by the NCB’s of the member states who have adopted the Euro.\textsuperscript{169}

Some recommendations from the IMF\textsuperscript{170} report need to be applied by BdI, such as the inconsistencies in the application of the requirement for a capacity opinion and a country opinion that should be obtained every two years, especially from the outside European Economic Area (EEA) on the finality and irrevocability of their payment through the system. The BdI should have more closed discussion with the ECB on the legal foundation and should seek the decree which is covering the technical rules on the standards of security, authenticity and integrity for the electronic processing of instructions for payments that are to be done by BIREL.

- The IMF Report of the FSAP on Netherlands (2004).\textsuperscript{171} This assessment stated that the major features of the Netherlands’ payments system were reflected in the assessment of the Europe-wide TARGET payments system undertaken in 2001. It was found that the TARGET system was broadly compliant with the Committee on Payment and Settlement Systems (CPSS) Core Principles for Systemically Important Payments System (CPSIPS). The FSAP on payment systems were not formally assessed in the Netherlands. Their attention in this assessment was focused on the securities settlement systems in light of the recent and pending developments in this area, using the CPSS/IOSCO RSSS. The assessors advised that the DNB should have a new law to address the need for a stronger legal basis for the supervision of such systems (of securities settlement systems and as well as of payments systems more generally).

\textsuperscript{168}It has the 1993 Banking Law and the 1998 Consolidated Law on Financial Intermediation. Italy has also Legislative Decree No.43 of March 10, 1998 which incorporated the provisions of the Community law concerning the ESCB into the Italian laws. With regard to the cross-border credit transfers, Italy also has a Legislative Degree No.253 of July 28, 2000, adapting Directive 97/5/CE, which governs credit transfers of up to €50.000. Finality settlement and insolvency issues are stated in Legislative Decree No.210 of April 12, 2001.

\textsuperscript{169}Guideline ECB/2001/3 of April 26, 2001 defines TARGET as the Trans-European Automated Real-time Gross settlement Express Transfer system for the Euro; it is composed of the domestic RTGS systems, the ECB payment mechanism and the Interlinking system. Annex 1 to the Guideline lists the real-time gross settlement systems which are part of TARGET, including the “Sistema di regolamento lordo BIREL”. See the official journal of the European Community, L.140 of May 24, 2001 (2001/401/EC).

\textsuperscript{170}Italy – IMF Report No. 04/132, \textit{Op cit.}

Spain has also been assessed by the IMF in 2005 and 2012. In its report, Banco de España (BE) has a legal basis for the RTGS, which is sound and contains clear rules and procedures such as the Law 13/1994, the Law 41/1999, known as the Settlement Finality Law for authorization on payment systems, and the Circular 3/2000. Spain has one large value payment systems (RTGS), named Servicio de Liquidación del Banco de España (SLBE), owned, operated, and controlled by the BE, which is considered as the only systemically important payment system. This is a part of the TARGET, and it settles both domestic and cross-border transactions. IMF has some recommendations for the BE, especially in consolidating its payment circulars to improve readability and transparency for participants and in monitoring the use of the liquidity reservation facility to avoid possible discrimination against certain payments that may have to wait until the end of the day to be settled, and to make sure that it does not unduly prevent the central bank from debiting accounts during the day. In a 2012 IMF Report, is stated that “Overall, the authorities’ responsibilities with respect to the FMIs are clearly defined in the law, but further transparency on the Banco de España’s (BdE) responsibilities with respect to the FMIs other than payments systems is recommended.”

- Denmark, another European Union member, has also been assessed by the IMF (2007). In the IMF report, the Danish authorities declared that there were two payment systems that are systemically important: (i) KRONOS, the RTGS system for large-value payments; and (ii) Sumclearing, a multilateral netting system. The legal basis for KRONOS can be divided into five categories:

173 Article 7.3.d) of Law 13/1994 on the Autonomy of the Banco de España, establishes that the central bank is in charge of promoting the well-functioning of the national payment system. Law 41/1999 of November 12 on Payment and Securities Settlement Systems, the Settlement Finality Law, defines the terms acceptance, irrevocability and settlement finality (art. 10 and 11). Art. 13 regulates the insolvency procedure for the clearing and transfer of order. Circular 3/2000, in accordance with Law 41/1999 establishes that payment orders are irrevocable.
174 Spain - IMF Country Report No. 06/221, Opcit.
175 Ibid.
176 Ibid.
178 The author only describes the report on RTGS system
179 IMF Country Report No. 07/120, Opcit.
Danmarks Nationalbank Act;

b. General Danish law of contracts and property;

c. Regulations governing payment systems and collateral arrangements;

d. The contractual basis for KRONOS; and

e. The conditions of the ESCB for the participation of non-Euro area national central banks in TARGET.”

Danmarks Nationalbank considers that the act is needed for its operational role and for its catalyst and oversight role. In general, the KRONOS system has complied with the CP-SIPS, but there are some recommendations to be followed up such as the transparency on pricing; a reconsideration at the discretion powers with respects to access and exit; an analysis of the effects of language barrier, especially for remote members with regard to the open access and the promotion of the Danish financial markets; and formulating explicit exit procedures in rules and regulations.

Based on the IMF reports on the assessment on ASEAN and the EU members mentioned above, the author analyses that the RTGS system, in general, complies with the Core Principles Systemically Important Payment System (CP-SIPS), especially TARGET, which has been used by the EU. It is interesting to note that some recommendations were emphasized on every report, and were all in the same aspect i.e. legal issues or technical aspects related to the other core principles such as transparency and dissemination of rules and procedures, pricing, liquidity aspect, oversight and governance. But again, in general they already comply with CPSIPS.

The author may also note that a sound legal basis is one of the very important principles that are required not only for the RTGS system but also for all the systems. The systems need to be tested periodically. The regulations, rules and procedures need to be updated and be accessed accordingly, in line with the development of economy and technology. Furthermore, the regulation should be clear, transparent and enforceable, in order to provide legal certainty. They also need to be disseminated and to be known and understandable to all parties involved. Last but not least, the author emphasizes that the important role of these principles are to be a guideline for the central banks to carry out an oversight of their payment systems for the safety and efficiency of transactions, so the risks which may arise can be reduced or prevented, then the transactions run smoothly.

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180 Effective as of March 1, 2006, the Danish Parliament approved the amendment on the Securities Trading Act, in which the oversight task of the central bank with respect to payments and clearing and settlement systems is explicitly set out in this act.

181 The author observes that the principle of a well-founded legal basis becomes a principle no. 1 in both, CP-SIPS Principles and Principle of FMI, because it is a very fundamental principles for creating and implementing a wide-range financial system.
Based on the FSAP report, the author does not see the big differences between the RTGS system used by the ASEAN countries and the one used by the EU countries, because both systems have the same standard and procedures. They also have similar features. It seems to the author that the integration of the RTGS system among the ASEAN members will run smoothly and may be adopted by following the EU’s experience. However, before adopting it, it is better to understand the background of the integration of the RTGS system operated by the European Central Bank (ECB).

With regard to the EU members’ RTGS assessments, the system is linked to the TARGET system for all the EU members so that it integrates their cross-border transactions. How it works and how it is managed will be described in the next chapter.

3. **Summary**

This chapter provides a better understanding on the payment systems, especially the RTGS and its guiding principles. The author concludes that a payment system basically is categorized in two types: cash payment and non-cash payment. The non-cash payment is generally divided into two groups: large value payment system (RTGS) and retail payment systems (clearing, credit card, debit card, mobile payment, etc.). Payment systems also have risks: credit risks, liquidity risks, legal risks, operation risks, and systemic risks. The payment systems also have lots of benefits, especially the RTGS systems.

With regard to the risks, the BIS endeavours to diminish or mitigate such risks by providing guidelines/core principles on payment systems, known as the CPSIPS-RTGS and the FMI, to reassure that the design and operation of the payment systems, especially the RTGS, meet the requirements for safety and efficiency of the systemically important payment system worldwide. These principles cover all the risks mentioned above, so that such risks can be reduced or even eliminated. These principles have become the international standard and are part of the whole assessment of the financial sector.

Since the EU countries and the ASEAN countries have participated in the RTGS system, they should comply with these principles, which will be periodically assessed by the BIS and/or the IMF.

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182 The IMF and the World Bank use the CPSIPS and the PFMI for conducting their assessment.
CHAPTER 2

THE HISTORY OF THE EUROPEAN UNION AND THE BACKGROUND OF PAYMENT SYSTEM INTEGRATION OF THE TRANS-EUROPEAN AUTOMATED REAL-TIME GROSS SETTLEMENT EXPRESS TRANSFER (TARGET) SYSTEM IN EUROPE

1. The Establishment of the European Union

1.1 Introduction

The European Union (EU), one of the most influential regional organizations in the world, consists of 28 European members\footnote{At the beginning, the Treaty had been ratified by 12 countries: France, Germany, the Irish Republic, Spain, Portugal, Italy, Greece, Denmark, Luxembourg, Belgium, the Netherlands and the United Kingdom. Since then it was followed by the rest countries: Austria, Bulgaria, Finland, Sweden, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia, and Croatia.} and governing mutual economic, social, and security strategies. The EU was established by the Maastricht Treaty (the Treaty), which came into effect on November 1, 1993. Undoubtedly, the EU is the most far-reaching form of regional integration, not least because it also stands for an advanced, albeit far from optimal, system of macroeconomic coordination and monetary policy integration.\footnote{Fabian Amtenbrink, “Central Bank Challenges in the Global Economy”, in C. Hermann and J.P. Terhechte (eds.), “European Yearbook of International Economic Law 2011”, European Yearbook of International Economic Law 2. Springer-Verlag Berlin Heidelberg, 2011.}

Furthermore, the EU is based on the rule of law. This means that every action taken by the EU is founded on treaties, which have been approved voluntarily and democratically by all EU member states.\footnote{See at http://Europa.eu/about-eu/basic-information/decision-making/treaties/index_en.htm, last accessed on January 19, 2015.}

This chapter will discuss the history of the EU and the ECB as well as the payment system integration (TARGET) within the European area, conducted by the ECB.

1.2 The History of the Monetary Integration in the EU

The EU is a unique economic and political partnership between 28 European countries, which covers much of the continent.\footnote{See European Commission website, “Enlargement: From 6 to 28 Members”, at http://ec.europa.eu/enlargement/policy/from-6-to-28-members/index_en.htm, last accessed on January 19, 2015.} The EU is set up with the aim of ending the frequent and bloody wars between neighbours, which culminated in the Second World War. As of 1950, the European Coal and Steel Community (ECSC) began to unite the European
countries economically and politically in order to secure lasting peace. This then became the foundation of the establishment of the EU in the spirit of economic association with the signing of the Treaty. The Treaty was reflected further to enhance the European political and economic integration by creating a single currency - the Euro.

The establishment of the ECSC in July 1952 was the first step towards a supranational Europe. In March 1957, the six ECSC members signed the two Treaties of Rome, one of which designed the European Economic Community (EEC) aiming to attain integration via trade with a view of economic expansion. This establishment, in the opinion of the author, is the starting point of the realization of the Economic Monetary Union (EMU) and the ECB decades later, although the aims and objectives of the original treaty was much more limited because the idea of a single currency was not yet in mind of the founders of the Treaties of Rome. The ECSC Treaty established four major governing institutions namely: a High Authority or Commission, a Ministerial Council, an Assembly and a Court of justice. The Commission drafts the proposals; the Council prepares the standards; the Assembly/Parliament plays an advisory role and/or also one of the EU’s main law-making institutions; and the Court provides justice and settles legal disputes in all EU countries.

In 1969, the Commission had an initiative to set up the need for "greater co-ordination of the economic policies and the monetary cooperation". This initiative was then followed up by the Heads of State or the Government and the Ministers of Foreign Affairs of the member states of the European Communities in their summit meeting at The Hague on 1 and 2 December 1969 agreed to the establishment of the EMU, and they also decided that the Commission should have a draft by the end of 1970, a stage-by-stage plan with a view to creating an economic and monetary union. The proposal was set up by a group under the Prime Minister and Finance Minister of Luxembourg, Pierre Werner, (known as Werner Plan). It completed the task of looking into various aspects of the realization of economic and monetary union within the Community.

189 The ECSC members: Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany.
The Werner plan, however, was ahead of its time and failed. To a large extent, that fact also contributed to the collapse of the Bretton Woods system – due to the monetary policy of Nixon in 1971\textsuperscript{193} - which rendered the entire project a failure because of the catastrophic basic conditions.\textsuperscript{194} Then, in April 1972, the currency “snake” was established by limiting the margin of fluctuation between the exchange rates of the currencies within the EC to $\pm 2.25\%$ vis-à-vis the central parities, but it failed to stay linked to the US dollar (the “tunnel”).\textsuperscript{195} Furthermore, not all of the EEC countries were able to retain fixed exchange rates. With the quickly changing external circumstances such as inflation and increasing oil prices and the lack of common priorities and policy objectives, the EMU failed to be relaunched during the 1970s.\textsuperscript{196}

Although the EMU plan was unsuccessful in the 1970’s, there were still last efforts to push for a European monetary integration. One of these plans was the proposal to launch an EEC system of fixed but adjustable exchange rates, framed as the European Monetary System (EMS),\textsuperscript{197} launched in March 1979. Scheller describes that some features of the EMS were similar to the “snake”. For example the EMS was also built around a grid of fixed but adjustable central rates among the participating Community currencies.\textsuperscript{198} He also explains that a new feature, however, was the introduction of the European Currency Unit (ECU), which was defined as a “basket” of fixed quantities of the currencies of the member states.\textsuperscript{199}

The EMS was not very successful in the early period, but was in some respects somewhat successful in the period of the EMU re-launching. It began when the Committee of Governors of the Central Banks of the member states\textsuperscript{200} supported and adopted measures designed to strengthen the EMS in 1985.\textsuperscript{201} Amy Verdun affirms that this period became the symbol of the successful European integration during which the member state Governments

\textsuperscript{193}American President, Richard Nixon in August 1971, terminated the gold convertibility of the dollar.
\textsuperscript{196}For a detailed argument, see Amy C. Verdun, “European Responses to Globalization and Financial Market Integration : Perceptions of Economic and Monetary Union in Britain, France and Germany”, Houndmills: Macmillan/New York : St. Martin’s Press, 2000, pp.61-75.
\textsuperscript{197}EMS is the system where most nations of the EEC connected their currencies to prevent large fluctuations relative to one another.
\textsuperscript{199}The value of the ECU vis-à-vis the US dollar was the weighted average of the US dollar exchange rates of the component currencies. Its value in each of the component currencies was determined by multiplying its US dollar value with the US dollar exchange rate of the respective component currency.
\textsuperscript{200}Committee of Governors of the Central Banks-of the European was established by the decision of the Council of the European Economic Community of 8 May 1964.
started to consider the exchange rates too much more “fixed” than was economically desirable.\textsuperscript{202}

In February 1988, Hans-Dietrich Genscher, a German Minister of Foreign Affairs proposed a memorandum with the title ‘A European Currency Area and a European Central Bank’ which presented both as an economically necessary completion of the European Internal Market.\textsuperscript{203} He emphasized that the ECB should be set up and he wished to promote the use of the ECU as a general means of payments in Europe and reduce European dependence on the dollar.\textsuperscript{204} Genscher also insisted on the autonomy of the ECB and the NCBs from political instruction and on the sole goal of price stability.\textsuperscript{205} In June 1988, the Heads of State and Governments decided at a European Council meeting in Hanover to set up a committee to study and propose “concrete stages leading towards this union”.

The committee was chaired by Jacques Delors, President of the European Commission. It comprised (i) the presidents or governors of member countries’ central banks, (ii) another commissioner (iii) and three experts.\textsuperscript{206} The Delors Committee in its unanimous report, submitted in April 1989, defined the monetary union objective as a complete liberalization of capital movements, full integration of financial markets, irreversible convertibility of currencies, irrevocable fixing of exchange rates, and the possible replacement of national currencies with a single currency.\textsuperscript{207} This could be accomplished in three stages and Scheller called it in three “discrete but evolutionary steps”.\textsuperscript{208} Furthermore, Jakob de Haan and Helge Belger also argue that these three-stage programmes of Economic and Monetary Union will turn the European Community into a true single market.\textsuperscript{209}

The three stages towards EMU can be described as follows:\textsuperscript{210}

\begin{quote}
\textit{- Stage 1 (1990-1994) Complete the internal market and remove restrictions on further financial integration.}
\end{quote}


\textsuperscript{203}David J. Howarth and Peter Loedel, “The European Central Bank: The New European Leviathan?”, \textit{Palgrave Macmillan}, 2003, pp. 35. The Proposal is about a European central bank with well-defined characteristics – including a procedure for bringing it into existence.

\textsuperscript{204}Ibid.

\textsuperscript{205}Ibid.

\textsuperscript{206}Ibid. This committee was consisted of a group of economic, financial and monetary specialists, each of whom had affinity with the EC integration process. See also Hanspeter K.S., “The European Central Bank: History, Role and Function”, pp.21.


\textsuperscript{208}Hanspeter K.S, \textit{Op. cit.}


- **Stage 3 (1999 onwards)** Fix final exchange rates and transition to the Euro. Establish the ECB and ESCB with independent monetary policy-making. Implement binding budgetary rules in member states.”

The establishment of the European Monetary Institute (EMI) in Frankfurt on 1 January 1994 showed the commencing of the second phase of the EMU. The EMI began to coordinate monetary policy among the national central banks, based on the Maastricht Treaty, which had been signed in 1992, required to be independent, as well as working on the details of the single currency. The Committee of Governors ceased to exist but was effectively reconstituted as the Council (governing body) of the EMI.211 The two main tasks of the EMI are to strengthen central bank cooperation and monetary policy co-ordination, and to make the arrangements required for establishing the European System of Central Banks (ESCB), for the conduct of the single monetary policy and for the design of a single currency in the third stage. The EU countries then at that time were preparing for the transition from their national currencies to the Euro.

1.2.1 The European System Central Bank (ESCB) and The European Central Bank (ECB)

The third stage can be indicated as the completion of all community currencies in the Exchange Rate Mechanism (ERM) and for its achievement, it is essential to revise the Rome Treaty in order to set up the future European System of Central Banks (ESCB). The ESCB would take up all its responsibility as foreseen in the Treaty, including the formulation and implementation of the monetary policy in the Community. Hence, it can be concluded that the central bankers who until then had been conducting monetary policies, had set forth these monetary judgments to restructure policy-making, and transfer them to a new European institution, the European Central Bank (ECB). This was becoming the starting point of the establishment of the ECB.

As mentioned above, the structure of the ECB was outlined in the Maastricht Treaty as part of the program to create Economic and Monetary Union (EMU). The Treaty set up the ESCB and a European Monetary Institute (EMI). The primary objective of the ESCB is price stability, but this is not defined explicitly in the Maastricht Treaty.212

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The ESCB has no legal personality and no capacity to act and no decision-making bodies of its own. Its composition comprises of the ECB and the NCBs of all EU member states.\textsuperscript{213} Hence, the ESCB as an institutional framework, which establishes an ‘organic link’ between the ECB and the NCBs, ensures that i) decision-making is centralized, and ii) the tasks that the EC Treaty has assigned to the ESCB are performed jointly and consistently in line with the allocation of powers and the objectives of the system.\textsuperscript{214}

1.2.2 The Commencement of the European Central Bank (the ECB)

With the establishment of the ECB on 1 June 1998 and the commencement of its operation on 1 July 1998, the EMI had ended its tasks. In accordance with Article 123 paragraph 2 (ex-Article 109I) of the Treaty of Amsterdam, amending the Treaty on European Union (TEU), the Treaties establishing the European Community (TEC) and certain related acts\textsuperscript{215}, the EMI shall go into liquidation upon the establishment of the ECB. All the preparatory work entrusted to the EMI was concluded in good time and the rest of 1998 was devoted by the ECB to the final testing of the systems and procedures.\textsuperscript{216} The establishment of the ECB was one of the objectives of the TEU set in the preamble and the TEC set in Article 2. The principle provisions of the ECB are comprised in Articles 8, 105 to 124 TEC.

Besides The Treaty of Amsterdam, the Treaty of Nice\textsuperscript{217} also instituted the amendments and the renumbering of the TEU and TEC. Hence, these became the consolidated versions of the TEU and the TEC incorporating the changes made under the Treaty on the European Union, 2006.\textsuperscript{218}

Compliant with Article 105(2) TEC, the ESCB has the basic tasks to carry out as follows:

“- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 111 of the EC Treaty;
- to hold and manage the official foreign reserves of the member states; and
- to promote the smooth operation of a payment system.”

From this article, the author argues that the establishment and operation of the ECB is one of the most important steps in the whole process of the European integration to back up the tasks of the ESCB. Why? Because the monetary policy and the

\textsuperscript{213}See Article 107(1) TEC (was amended by Article 129(1) (TFEU)).
\textsuperscript{214}Hanspeter K.S., Opcit., pp.42.
\textsuperscript{215}See Official Journal C 340/1, 10.11.1997.
\textsuperscript{217}See Official Journal C 80/3, 10.3.2001.
payment system integration are important key roles in carrying out the EU economy. The EU needs an institution, which could manage the economy and monetary aspects within the EU member states under one roof and this is not an easy task for the ECB.

On 1 January 1999, the third and final stage of the EMU, it commenced with the irrevocable fixing of the exchange rates of the currencies. Eleven member states\(^{219}\) were initially participating in the Monetary Union and conducted a single monetary policy under the responsibility of the ECB. The ECB is embedded in the specific legal and institutional framework of the European Community. What distinguishes ECB and NCB is the ECB’s supranational status within a community of sovereign states. With regard to the ECB’s independence, Jakob de Haan states that the Maastricht Treaty made the European Central Bank (ECB) politically independent.\(^{220}\) The Treaty on Functioning of the European Union (TFEU),\(^{221}\) and the Statute of the ESCB provide an independent status for the ECB and the NCB of the EU member states. Renè Smits simply divides the independent status of the ECB into four elements: institutional independence, functional independence, financial independence and personal independence.\(^{222}\)

Institutional independence of the ECB is based on Article 108 of the EC Treaty (was amended by Article 130 TFEU). It states as follow:

> "when exercising their powers and carrying out their tasks and duties, either the ECB nor an NCB nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a member state or from any other body."

This article means that the ECB, as a legal autonomy of the monetary authority, has its own institution separate from the other bodies of the government and it is not allowed to seek or take any instructions from any other body or even from any government.

Carol affirms that this Treaty grants the ECB full constitutional independence.\(^{223}\) She also states that it explicitly explains that neither the ECB nor any member of its decision-making bodies shall seek or take instructions from the European Commission, from any government of any member states, or from any other organization or institution.

\(^{219}\) The eleven members are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portuguese, and Spain.


\(^{221}\) The EC Treaty was amended by the Treaty on Functioning of the European Union.


With regard to its the functional independence, the ECB has the objectives to conduct the monetary policy and to pursue the price stability. In performing the tasks and objectives, the ECB and the NCB’s could not be influenced by the Community institutions or by bodies from any government of a member state.\textsuperscript{224} Hence, the ECB has the sole right to carry out its function as a monetary authority for the EU without any interference from other parties.

The financial independence means that the ECB manages its own budget, which is separated from the EC’s budget.\textsuperscript{225} Its budget is not even subject to approval by the minister of finance. Moreover, Article 26(2) of the ESCB Statute states that:

\begin{quote}
“the annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council. The accounts shall be approved by the Governing Council and shall thereafter be published.”
\end{quote}

The capital of the ECB for its establishment shall be 5.000 million Euro.\textsuperscript{226} The ECB shall also take responsibility for the allocation of the monetary income of the national central banks and of the net profits and losses of the ECB respectively.\textsuperscript{227} Regarding personal independence, the ECB has such privileges and immunities for the performance of its tasks, by having its own decision-making bodies, staff, salaries and other benefits.\textsuperscript{228} The dismissal of the officer could not be done by the reasons interrelated to the government/parliament decision but it is only possible if there are serious matters unrelated to the policy of the ECB.

In terms of independence, the author agrees that this is also one of the most important issues for managing a region’s monetary policy, because without independence, the government or other parties will be able to intervene. The central bank should be independent of political and economic influence from the government and other parties. This privileged independence is supported by the EU legislation according to Article 282(3) (TFEU).

The ECB has also the law-making powers to carry out its tasks, such as making regulations, decisions, recommendations, guidelines as well as fines and penalty payments.\textsuperscript{229} The law making powers shall be binding and directly applicable in all member states. These status and powers demonstrate that the ECB can be named as a supranational body/institution. The ECB shall also enjoy in each of the member states the most extensive legal capacity and can even undertake actions in the private law area, for instance, making contracts, acquire or dispose of movable and

\begin{tabular}{l}
\textsuperscript{224}See Article 108 TEC. \\
\textsuperscript{225}See Article 12(1) and 26(2) of the ESCB Statute. \\
\textsuperscript{226}See Article 28 of the ESCB Statute. \\
\textsuperscript{227}See Article 32(6) and 33 of the ESCB Statute. \\
\textsuperscript{228}See Article 112(2)(b) TEC and Article 11, 36 and 40 of the ESCB Statute. \\
\textsuperscript{229}See Article 110 TEC and Article 12(1) and 34 of the ESCB Statute.
\end{tabular}
immovable property, and be a party to legal proceedings. So, the ECB could make agreements with the other party for the purpose of its tasks. Unlike the ESCB, the ECB has a legal personality and has the capacity to act but that should be in line with its objectives, the rules of the Treaty, and the Statute, as well as with the decision-making bodies of the ECB. The ECB also has a right to resolve international arrangement with the IMF, the BIS and the Organization for Economic Co-operation and Development (OECD).

The ECB could perform as a policy function, although it is not a public institution like the European Parliament, the Council, the European Commission, the Court of Justice, and the Court of Auditors. These institutions are assigned with the broad mandate of performing the tasks of the Community within the limits of the powers deliberated to them by the Treaty. The ECB has a specific status within the whole framework of the European Community and carries out its activities with a well-defined peculiar task. The ECB has not received its delegated power from the Community institutions, and this distinguishes the ECB from other decentralized agencies such as the European Environment Agency and the Office for Harmonization in the Internal Market, whose competences are delegated by the Community institutions.

The ECB has three-structural bodies. These bodies are the Governing Council, the Executive Board, and the General Council. The Governing Council is the main decision making body of the ECB and, according to Article 10 of the Statute of the ESCB, is managed by six members of the executive board, consisting of the president, vice-president and four members nominated by the Eurozone countries, plus the governors of the national central banks of the 17 Euro area countries. Its main role is to adopt the guidelines and take decisions necessary to ensure performance of the tasks entrusted to the Euro-system and to formulate monetary policy for the Euro area. This includes decisions relating to monetary objectives, key interest rates, the supply of reserves in the Euro-system, and the establishment of guidelines for the implementation of those decisions. Jakob de Haan and his colleagues have their opinion related to the independency of the Governing Council:

230 See Article 9.1 of the ESCB Statute.
231 The ECB has legal personality under Article 282(3) (TFEU) and has the most extensive legal capacity under the respective national law of each member state under Article 9.1 of the Statute of the ESCB.
232 See Article 7 TEC
234 Ibid. See also Jakob, et al., 2005.
“However, when taking monetary decisions, the members of the Governing Council of the ECB are not expected to act as national representatives but rather in a fully independent personal capacity.”

The second of decision-making body is the Executive Board. In accordance with Article 11 the Statute of the ESCB, the Executive Board consists of the President, the Vice-President and four other members who are appointed by the European Council, through a qualified majority. Its main role is to implement monetary policy for the Euro area in accordance with the guidelines specified and the decisions taken by the Governing Council; to prepare Governing Council meetings; to manage the day-to-day business of the ECB; and to exercise certain powers delegated to it by the Governing Council. These include some of a regulatory nature.

With regard to the Executive Board body, Daniel Gros and Niels Thygesen compared it to the Federal Open Market Committee (FOMC) of the Federal Reserve in USA. The FOMC meets every five to six weeks, and has its functions analogous to those envisaged for the ECB Governing Council in setting monetary objectives and in formulating guidelines for the main policy instrument, open-market operations, to be undertaken through the Federal Reserve Bank of New York. Their comparison reached a conclusion that the ECB Executive Board is likely to have a relatively weaker position with respect to both decision-making and policy implementation than the Federal Reserve. They furthermore revealed that The Board will be squeezed from one side by the Governing Council, the repository of all major policy-making authority, and from the other side by the participating NCBs, anxious to preserve as many operational tasks as possible, partly to retain influence for themselves partly to defend the perceived interests of their employees. The author has a different opinion. The ECB has three bodies and the Executive Board is a kind of extension of the Governing Council, whose tasks are to assist and to smoothing the Governing Council’s policies. On the other hand, the Executive Board has certain powers and authorities to run day-to-day business. Thus, this co-ordination will mutually strengthen and support each other.

The last body of the ECB is the General Council, which comprises of the President of the ECB; the Vice-President of the ECB; and the governors of the national central

235 Jakob de Haan, et al., “The European Central Bank: Credibility, Transparency, and Centralization”, Opcit., pp.10. Although members of the ECB Governing Council do not act as national representatives, but as fully independent persons, it is certainly possible that national economic welfare plays at least some role in the voting behavior of regional representatives in the ECB Council., pp.167.

236 See also the ECB website, at http://www.ecb.int/ecb/orga/decisions/eb/html/index.en.html, last accessed on January 19, 2015.

237 Ibid.


239 Ibid.
banks (NCBs) of the 28 EU member states. In other words, the General Council consist of representatives of the 19 euro area countries and the 9 non-euro area countries. The General Council has the main tasks of being the ECB’s advisory functions, collecting statistical information, preparing the ECB’s annual report, setting up the necessary rules for standardizing the accounting and reporting of operations undertaken by the NCBs, taking measures relating to the establishment of the key for the ECB’s capital subscription other than those laid down in the Treaty, laying down the conditions of employment of the members of staff of the ECB and taking necessary preparations for irrevocably fixing the exchange rates of the currencies of the “EU member states with a derogation” against the Euro.

By these decision-making bodies under Article 8 of the Statute of the ESCB, the ECB has the instruments to efficiently work to handle their respective tasks. Furthermore, the ECB has also the authority to make regulations, carry out supervisions and even impose sanctions. By this authority the ECB is entitled to impose fines or periodic penalty payments on undertakings for failure to comply with its regulations and decisions. It ensures uniform and effective imposition of sanctions through full collaboration with the ECB by the national central banks of the euro area. All measures taken by the ECB have a legal binding effect but are open for review or interpretation by the European Court of Justice (ECJ).

The author sees that this authority gives the ECB, as an institutional body for the EU member states, the power to make regulations, which will automatically be accepted in all the member states’ jurisdictions and is directly applicable and have been adopted by the members of the Euro-system. The regulations made by the ECB, already provides a certainty of law regarding the enforceability to all the EU member states. However, when conflict of laws arises among the parties, they can find justice at the ECJ.

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240 See ECB website, at http://www.ecb.int/ecb/orga/decisions/genc/html/index.en.html, last accessed on January 19, 2015. The nine non-euro are countries are Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, Sweden, and the United Kingdom.

241 According Article 141 (TFEU), the General Council is considered as a third decision-making body. If and as long as there are Member States with a derogation. In this case, if there is no member states with a derogation, that the General Council is not considered as a decision-making body and is not allowed to do something related to decision-making tasks.

242 Ibid.


The ECB clearly holds an important role for the Economic and Monetary Union. Before a member state joins the Eurozone, it must prove that it has fulfilled some requirements/criteria over a long-term period, known as the economic convergence. This convergence is a method to assure equal treatment of member countries in the Euro area, especially when new member countries want to join the EU.\textsuperscript{246} The ECB has to examine each member state who would like to join the Eurozone. The requirements for the adoption of the single currency are: a high degree of sustainable convergence (economic convergence) and compatibility of the national legislation with the Treaty provisions on EMU, which will be assessed by referring to the following criteria:\textsuperscript{247}

\begin{itemize}
  \item the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing member states in terms of price stability,
  \item the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 104(6),
  \item the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other member state,
  \item the durability of convergence achieved by the member state and of its participation in the exchange-rate mechanism of the European Monetary System being reflected in the long-term interest-rate levels.”
\end{itemize}

These four criteria should be independently assessed by the ECB and the European Commission both for economic and legal convergence, then they should report to the EU Council (meeting in both the ECOFIN composition and the composition of the Heads of State or Government).

For legal convergence, the ECB will examine:\textsuperscript{248}

\begin{itemize}
  \item the independence of the NCB (legal, institutional and functional independence and security of tenure of the members of the decision-making bodies);
  \item the legal integration of the NCB into the ESCB (including statutory objectives, tasks, instruments, organization and financial provisions);
  \item other legislation which has a bearing on the full participation of the member state in Stage Three of EMU (including provisions on the
\end{itemize}

\textsuperscript{247}See Article 121(1) of the EC Treaty.
\textsuperscript{248}Hanspeter K.S., Opcit., pp.37.
issue of banknotes and coins, holding and management of foreign reserves and exchange rate policy).”

One thing that the author notes is that the national legislation of all member states, including the statutes of their NCBs, must be compatible with the Treaty and the Statute of the ESCB and of the ECB, based on Article 131 (TFEU), in order to be integrated. These mean that the NCB of every member state should adopt the regulations and statutes related to the ECB’s regulations and by means of these adoptions, the NCB member states must comply with the ECB’s regulations or policies.

To distinguish between the NCBs Eurozone and non-Eurozone, Scheller also describes the term of ‘Euro-system’, which has been adopted by the Governing Council of the ECB in November 1998 to refer to the composition of the ECB and the NCBs of the Member Countries who have adopted the Euro.249 There are three reasons why the term Euro-system was established to carry out central bank functions for the Euro, and not a single central bank:250

“1. The establishment of a single central bank for the whole Euro area (possibly concentrating central bank business in one single place) would not have been acceptable on political grounds.

2. The Euro-system approach builds on the experience of the NCBs, preserves their institutional set-up, infrastructure and operational capabilities and expertise; moreover, NCBs continue to perform some non-Euro-system-related tasks.

3. Given the large geographic area of the Euro area, it was deemed appropriate to give credit institutions an access point to central banking in each participating member state. Given the large number of nations and cultures in the Euro area, domestic institutions (rather than a supranational one) were considered best placed to serve as points of access to the Euro-system”.

To perform its tasks on monetary policy the ECB, like other central banks, is using a basic instrument namely the interest rate, by using an intervention tool called open market operations.251 The author is going to discuss the other instruments that may support the monetary policy, which are also very important to support the monetary

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249 The term ‘Euro-system’ is used to distinguish between the member states that have adopted the Euro and the other member states that have not joined the Euro, yet.

250 Ibid

251 The open market operation which is conducted by Bank Indonesia can be explained: purchasing and selling of government securities, such as Bank Indonesia purchases and sales of Bank Indonesia Certificates (SBI) by monthly auction. Another example, the Federal Reserve uses U.S. Treasury and the federal agency securities, for implementing its monetary policy. These interventions could influence the foreign exchange market and also the exchange rate. Then, it will have an effect on inflation (the money supply and demand).
policy, based on Article 105(2) (was amended by Article 127(2) (TFEU)), the last point.\textsuperscript{252}

To support an effective monetary policy, the efficient and safety payment and settlement systems are one of the crucial instruments. Based on Article 3.1 the ESCB statute, one of the basic tasks of the ESCB is to promote the smooth operation of payment systems. There was a fundamental need to build up a payment service to serve the needs of what would be a single monetary policy. The legal basis for the Euro-system’s capability in the area of payment and settlement systems is also contained in Article 127(2) of the Treaty on the Functioning of the European Union (TFEU). To promote the smooth operation of payment systems, the Euro-system actively cooperates with other bodies and institutions. First is the cooperation with the EU Commission, which strives for further harmonization of the laws within the Union by issuing a directive to be implemented in the national law of the member states. Second is to cooperate with the Committee on Payment and Settlement Systems (CPSS) of the G-10 central banks, coordinated by the BIS.

In accordance with Article 22 of the Statute of the European System of Central Banks and of the European Central Bank, it is clearly stated as follows:\textsuperscript{253}

\begin{quote}
“the ECB and the national central banks may provide facilities, and the 
ECB may make regulations, to ensure efficient and sound clearing and 
payment systems within the Community and with other countries.”
\end{quote}

The task of making regulations on payment system within the Union and with other countries becomes the legal basis of the ECB to regulate the NCBs of member states. As with the regulations adopted by the legislative bodies of the European Community, the ECB regulations have general application, and are binding in their entirety. They are also directly applicable in all Euro area countries.\textsuperscript{254} Scheller explains that general application means that they are applicable to an unlimited number of entities and cases. Directly applicable means that, ECB Regulations become part of the national law without intervention of Parliament.\textsuperscript{255} As binding legal acts, they impose direct obligations on third parties. Such regulations take effect as soon as they are published by the European Commission.

Accordingly, the ECB has been established by the EC Treaty, as a specialized, independent organization for conducting monetary policy and performing related functions, such as, in this discussion, as an operator of the TARGET system for payment system cross-border transaction.

\textsuperscript{252}Maastricht Treaty Art.105 (2), was amended by Article 127(2) (TFEU) : The basic tasks to be carried out by the ESCB shall be: “…to define and implement the monetary policy of the Community; to conduct foreign exchange operations consistent with the provisions of Article 109; to hold and manage the official foreign reserves of the Member states; to promote the smooth operation of payment systems.

\textsuperscript{253}See Article 22 of the Statute.

\textsuperscript{254}See Article 34.2 of the Statute.

In 2007, the Lisbon Treaty was signed. It made big changes on the ECB. In accordance with Article 13 TEU of the Lisbon Treaty and Part IX, Title 1, Chapter 1 and Section 6, the ECB becomes one of the European official institutions such as the European Parliament, the European Council, the Council of the EU, the European Commission, the Court of Justice and the Court of Auditor. On the one hand, the ECB changes into an institutional framework under the EU constitutional order. The ECB becomes part of the core institution of the EU. On the other hand, the independency of the ECB will be questioned. As we can see, Article 108 TEC states that:

“When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a member state or from any other body. The Community institutions and bodies and the governments of the member states undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.”

Compare this to Article 282(3) of the Lisbon Treaty, which states that:

“The European Central Bank shall have legal personality. It alone may authorize the issue of the Euro. It shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the member states shall respect that independence.”

The author sees that those two articles above imply a concept of independence. But in the new clause of the Lisbon Treaty, the author sees that the ECB’s independence is not literary stated to not be influenced by the other parties as stated in the article on TEC. Some academics and practitioners have different opinions on that issue. The Executive Board of the ECB, Dr. Lorenzo Bini Smaghi states that the independence of the central bank needs to be continuously protected and maintained over time, and this is the responsibility of the political institutions. Nevertheless, the Lisbon Treaty has strengthened the ECB’s independence by explicitly introducing its financial independence in primary law.

In addition, Article 3(1)(c) TFEU provides that the EU shall have exclusive competence in the monetary policy of the member states whose currency is the Euro. Consequently, only the ECB has the power to legislate and legally adopt acts relating

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to EMU. The term Euro-system was introduced in this treaty. By these regulations, the ECB has the power to smooth the payment system by regulating and operating the TARGET system, which supports the monetary policy in the EU. The creation of the Euro area and a new supranational institution, the ECB, was a milestone in the long and complex process of European integration.²⁵⁸

1.2.3 The Role of the National Central Bank’s (NCB) in the EU

Like the ECB, the NCBs of the Euro-system also have a legal personality within the national law of the respective country. However, all NCBs in the Euro area are integral parts of the Euro-system by virtue of Article 105 of the EC Treaty and Article 14.3 of the Statute of the ESCB.²⁵⁹ In Article 14.3 of the Statute it is clearly stated that “the national central banks … shall act in accordance with the guidelines and instructions of the ECB”, so it means that the Statute mandates the NCBs to comply with the ECB’s policy.

The EU has NCBs as a part of the Euro-system and NCBs of the non-EU member states. As part of the Euro-system, the NCBs and their management should also be independent, like the ECB. This independence has been protected in both the EC Treaty and the Statute of the ESCB. The government may not interfere with the tasks and objectives of the NCB and the governor of the Central Bank in line with the functioning of the Euro-system.

The NCBs of the non-EU member states are also members of the ESCB but have a different status. They are responsible for their respective national monetary policies and are therefore excluded from taking part in the main activities of the Euro-system. Their governors are not members of the ECB’s Governing Council and do not take part in the decision-making process for the Euro-system’s duties. The non-EU NCBs are, however, obliged to comply with the principles of price stability-oriented monetary policy. Moreover, being members of the ESCB implies that they need to work thoroughly with the Euro-system in several subjects, such as supporting the ECB in the collection of statistics.²⁶⁰ In addition, the European Exchange Rate Mechanism II (ERM II) provides a framework for monetary and exchange rate policy cooperation with the Euro-system.²⁶¹

²⁵⁹Ibid., pp.44.
²⁶¹Official Journal C 362, 16.12.2000. See Agreement of 14 September 2000 between the European Central Bank and the national central banks of the Member states outside the Euro area amending the Agreement of 1 September 1998 laying down the operating procedures for an exchange rate mechanism in stage III of economic and monetary union, amending Agreement of 1 September 1998 between the European Central Bank and the national central banks of the Member states outside the Euro area laying down the operating procedures for an exchange rate mechanism in stage three of Economic and Monetary Union (Official Journal C 345, 13.11.1998).
Nout Wellink, the former President of De Nederlandsche Bank and the former Director of the Bank for International Settlement, made a statement in the Oesterreichische Nationalbank Conference ‘Competition of Regions and Integration in EMU’, at Vienna, 13-14 June 2002, as follows:262

“The national central bank in Europe is of a peculiar sort and has a double identity. On the one hand, it is deeply rooted in national tradition and sovereignty, which reflects specific national tasks and responsibilities. On the other hand, it is part of a system of central banks responsible for a fully supra nationalized monetary policy and related, common tasks.”

It can be said that the responsibilities of the NCB, in terms of its domestic tasks, basically have clear links and synergies with the tasks of the ESCB, both of which should be carried out for the interests of its country and its part towards EU integration. For example, the tasks of financial stability in the EU, is also important for the NCB to carry out. But Wellink affirmed that the financial stability task is more appropriately located at the national level, although communication and coordination across borders are increasingly important. He also stated that this involvement in the financial stability is a natural reflection of other tasks, including monetary policy and payment system. The conclusion is that despite the fact that the NCBs have to execute tasks on national level, they are also responsible for carrying out tasks that are related to the country’s role as an EU member states. Hence, the NCBs must also comply with the policy of the ESCB, set forth in the Treaty on the EU, in order to ensure smooth coordination among the NCBs of all member states. The NCBs play double roles, given by their national law and by its community law.

2. The Background, Development and Legal Framework of the Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET)

The ECB states in the ECB Monthly Bulletin April 2004 the following:263

“The existence of efficient and robust large-value payment systems is of key importance for the smooth functioning of the economy. A large-value payment system should be efficient in order to ensure the uniform distribution of liquidity and a homogeneous level of short-term interest rates across a monetary area. This is a prerequisite for the efficient conduct of monetary policy operations. A large-value payment system should also be robust in order to cushion systemic risk and to contribute to financial stability. If a payment system for large-value transfers lacks robustness, not only could it cause disruptions in the financial

sector, but it could also allow these to spread from one market participant to another... With regard to the operational of large value payment systems, the Euro-system (the ECB) manages the TARGET system.”

As the author pointed out previously, according to Article 127(2) of the TFEU and Article 3.1 of the Statute of the ESCB, one of the basic tasks of the ECB is to promote the smooth operation of payment systems. In order to promote the smooth operation of a payment system, Article 22 of the Statute states that the ECB and the NCBs are entitled to provide facilities to ensure efficient and sound clearing and payment systems within the Community and other countries. The essence of these articles was commonly already contained in the statutes of each NCB prior to their integration into the Euro-system, so after joining the Euro-system, these functions became the shared competence of the ECB and the NCBs. Article 34.1 of the Statute of the ESCB also authorizes the ECB to make regulations and recommendations, take decisions and deliver opinions in the area of clearing and payment systems, which are binding on the participants. Such ECB regulations and decisions are directly applicable in the member states, which have adopted the Euro. It could also be concluded that the NCBs which have adopted the Euro must comply with the ECB regulations and decisions as provided by the Treaty and the Statute in their function as the legal basis for the engagement of the Euro-system in clearing and payment systems.

These legal provisions in the Treaty and the Statute of the ESCB are of particular importance with regard to payment and settlement systems. One of the payment systems, which play a very important role within the EU for cross-border transaction, is the RTGS, which is linked to TARGET. Basically, the Euro area monetary markets are worked by two core payment systems, TARGET and EURO1. TARGET is owned and operated by the ECB, and EURO1 is owned by the European Banking Association, providing settlement services on a net basis. In this dissertation, the author focuses on the TARGET system, which has made contribution to the fast-moving integration of the Euro market.

Prior to the introduction of the Euro and the launch of a single monetary policy in 1999, payments between the EU countries mainly relied on correspondent banking. But the correspondent banks were no longer considered appropriate and the establishment of an efficient and robust payment system for the Euro area as a whole was required. TARGET was created against this background. The main objectives of TARGET are to contribute to the singleness of the Euro money market in order to serve the needs of the single monetary policy implemented by the Euro-system, and to the soundness and efficiency of payment transfers in the Euro area. The impact of monetary policy operations is currently transferred to the money market via interbank funds transfer systems, which settle in the accounts of the central

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265 Ibid. Correspondent banking is an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks.
266 Ibid.
bank. Related to the start of stage three of EMU, there will be a single monetary policy and an integrated money market where the interest rate may vary from one country to another. So it is needed to apply one standard in the EU. Moreover, there will be a need for a payment arrangement amongst them and finally the EU central banks agreed to establish the TARGET system.

From the description above, the author may define that TARGET is created to support the objective of the EU to create a single market. It is a system composed of a real time gross settlement system in each of the EU countries, which is managed by the Eurosysten, which are interlinking with the ECB payment mechanism (EPM), which provides intraday, finality, and settlement in the central bank money. Each NCB should have an interface between its RTGS and the interlinking system. TARGET is designed in such a way that the system will be able to process cross-border payments in one currency (Euro) at low cost with more safety and real time settlement. the RTGS of the non-Euro countries may also be connected, provided that they are also able to process the Euro currency along with their national currency. Security and business continuity have always been one of its key features. TARGET is used to settle payments between participants located in the same country (domestic) or in two different countries of the EU (cross-border).

Fortunately, before the need for a single currency, the majority of the EU members already had their own RTGS system, but that system was only for the settlement of transactions in their domestic currencies. Hence, in March 1995, the EMI decided that all current EU NCBs should be ready to connect to TARGET by 1999. This development of TARGET was supported by the EU central banks’ collective decision, taken in November 1993, to implement real-time gross settlement systems in all EU countries.

Why had the EMI chosen the RTGS for interlinking to TARGET? Because the RTGS ensures that every single transaction will occur in real time and will be final. TARGET was developed to meet three main objectives:

"First and foremost, to facilitate the integration of the Euro money market in order to allow for the smooth implementation of the single monetary policy; second, to improve the soundness and efficiency of payments in Euros; and third, to provide a safe and reliable mechanism for the settlement of payments on an RTGS basis, thus contributing to a minimization of risks in making payments."

270Taken from the foreword of Alexandre Lamfalussy, the President of ECB in “Payment Systems in The European Union”, *European Monetary Institute*, April 1996.
In order to achieve these objectives, TARGET offers the possibility of transferring the central bank money on a cross-border basis as smoothly as in the domestic market, making it possible to reuse these funds several times a day.\textsuperscript{272}

From the experience of TARGET until present day, the author concludes that it has been proven that RTGS provides more safety and efficiency for cross-border transactions than the other payment systems, such as the netting system transactions.

Nakajima states that the RTGS system achieves finality earlier, which reduces the credit and liquidity risk, compare to the DTNS system.\textsuperscript{273} According to the “Outcome of the Global Payment System Survey 2010” conducted by the World Bank, 116 out of 139 countries (or 83\%) were using the RTGS system.\textsuperscript{274} This also confirms that RTGS has become one of the most important payment systems used, not only in the EU but also ASEAN and worldwide.

But at that time, there was no sufficient time to build a completely new system in time for the introduction of the Euro in all the EU countries. The most practical and immediate solution was to link the existing RTGS systems and define a minimum set of harmonized features for sending and receiving payments across national borders (i.e. inter-member state payment).\textsuperscript{275} Then, at the national level, central banks continued to function as they did for the settlement of payments within their banking community (i.e. intra-member state payments).\textsuperscript{276} The TARGET system was built by linking together the different RTGS structures, which existed at the national level. TARGET, the first-generation RTGS system for the Euro, commenced operation on 4 January 1999, following the launch of the Euro.\textsuperscript{277}

After the commencement of its operations, the national money markets were integrated effectively. The use and acceptance of a payment system largely depends on its safety and reliability. The ECB’s bulletin in April 2004 shows that in 2003, in spite of the decentralized structure of TARGET, the level of availability stood at 99.79\%.\textsuperscript{278} In this

\begin{itemize}
    \item \textsuperscript{272}Ibid.
    \item \textsuperscript{273}Masashi Nakajima, “The Evolution of Payment Systems”, Op cit. DTNS the acronym for the “Designated-Time Net Settlement”. A DTNS system is a net settlement system, thus the settlement of funds occurs on a net basis, usually in the end of the day.
    \item \textsuperscript{275}European Central Bank, “TARGET Annual Report 2008”, Op cit.
    \item \textsuperscript{276}Ibid.
    \item \textsuperscript{278}See further on “Monthly Bulletin April 2004”, pp.61 at https://www.ecb.europa.eu/pub/pdf/mobu/mb200404en.pdf, last accessed on January 19, 2015. Level of availability is associated to the availability of the system to be used that ensures a level of operational performance or the level of expectation of users against the system to be ready and working at all times. The greater the percentage of the level of availability, the better of its performance.
\end{itemize}
respect, TARGET has proven to be robust and resilient. The temporary service interruptions in TARGET were bridged by special contingency arrangements aimed at ensuring the smooth and timely processing of specific payments, whose delayed processing could have potentially triggered a systemic risk. Almost 96\%\textsuperscript{279} of the inter-member state traffic was being processed in less than 5 minutes. Due to exceptional service disruptions, the processing time exceeded 30 minutes for 0.28\%\textsuperscript{280} of inter-member state payments in TARGET. This report shows that the TARGET system has undoubtedly met its purposes i.e. to reduce systemic risk and enhance financial stability, and thus turn into the preferred system for cross-border transactions in Euro.

Nevertheless, during its journey, there have been also some demands in terms of technology and business practice regarding TARGET to keep its speed. For example, the needs for foreign exchange transactions, triggered the ECB to develop a new system, namely the Continuous Linked Settlement (CLS) which becomes part of the development of TARGET in order to provide this system for settling the foreign exchange transactions. According to the needs and demands of the market, the EU needs a more sophisticated version of TARGET, to accommodate the strong demand from TARGET users for a more harmonized service at the European level.

The ECB and the NCBs quickly moved to the next generation TARGET system. The main objectives that have been defined by the Euro-system for the second generation of TARGET, as stated in the IMF Country report in October 2001, were as follows:\textsuperscript{281}

- to better meet customers’ needs, in terms of availability, intraday information, and liquidity management;
- to provide a more harmonized service in order to ensure a level playing field for banks accessing TARGET via different RTGS systems;
- to ensure cost efficiency; and
- to be prepared for rapid adaptation to future developments, including, inter alia, technological progress and the likely enlargement of the Euro-system.”

Based on the IMF country report, on 24 October 2002, the Governing Council of the ECB continued its work by defining the strategic direction for the next generation of TARGET, with the aim of overcoming the shortcomings of the current system, which could render it incapable of meeting future challenges. Furthermore, the Governing Council has decided three main objectives for the TARGET2, and these are:\textsuperscript{282}

\textsuperscript{279}Ibid.
\textsuperscript{280}Ibid.
“- **TARGET2 should provide a harmonized level of service on the basis of a common technical platform;**
- **It should follow the principle of cost recovery and have a single price structure that is applicable for both inter-member state and intra-member state payments;**
- **It should meet new user demands including those from the ten new member states that joined the EU on 1 May 2004.**”

In December 2004, the Governing Council granted the evolution of TARGET by designing a single technical platform, known as the Single Shared Platform (SSP) for TARGET2, which is based on the joint agreement prepared by three NCBs of the Euro-system, namely the Deutsche Bundesbank, the Banca d’Italia, and the Banque de France. This evolution was designed to meet the participants’ requirements for more harmonized level of service and to increase cost-efficiency due to the decentralized structure, which multiplied the local technical components and, therefore, increased the maintenance and the running costs. Furthermore, the participants need a single price policy across the EU, which applies both to domestic and cross-border transactions, and also require flexible liquidity management facilities, high level of business continuity and effective contingency measures.

The ECB and the NCBs were eventually successful in transforming TARGET into TARGET2. It was launched on November 19, 2007.\(^{283}\) TARGET2 replaced the decentralized technical structure with the SSP. By using the SSP, each NCB will no longer be compulsory to maintain a payment processing platform of its own, but the settlement account relationship and the intraday credit extension still belong to the business relationship between each central bank and its national bank industry. This development will reduce the costs per transaction and will provide harmonized level of service in order to maintain a level playing field amongst the TARGET users.

Participants may use TARGET not only to make large-value transactions, but also to facilitate settlements in other interbank funds transfer system, such as CLS and to resolve money market, foreign exchange and securities transactions. It can also be used for small-value transactions.

### 2.1 The Structure and the Objectives of TARGET

TARGET at first had a decentralized structure, which was composed of each RTGS system of the NCBs Euro area, on the one hand, and the ECB payment mechanism, on the other hand, and has been replaced by TARGET2 in 2007 with the characterized structure, the SSP. The NCBs, which are not in Euro area, like Denmark, Poland, Estonia, Slovenia and the United Kingdom, are also able to connect to TARGET, subject to certain additional

conditions and specifications. This interlinking will provide a uniform platform which will acknowledge payment orders to move from one RTGS system to another within the member states. By using TARGET, the payment settlement in the central bank money is immediately irrevocable and final. This eliminates both the settlement risk and the credit risk and substantially reduces the systemic risks. The ECB in particular, requires the payments, related to monetary policy operations involving the Euro-system or to the final settlement of systemically important payment and settlement systems, to be made via TARGET. This categorizes the TARGET system as a systemically important payment system (SIPS) and should comply with the Core Principles for Systemically Important Payment Systems (CPSIPS).

With regard to CPSIPS, TARGET provides a guarantee to eliminate service interruptions, poor performance, and low security level in payment processing by striving to ensure:

“i) a very high operating level in terms of TARGET availability, and short processing times (as measured by the business performance indicator, for example);

ii) the secure processing of payments in TARGET (including protection against any type of threat); and

iii) compliance with the internationally agreed Core Principles for Systemically Important Payment Systems.”

Having the new SSP structure of TARGET2, the ECB may achieve its objectives and support its goal to strengthen the economic integration process. In 2006, before being replaced by TARGET2, it had processed more than 83 million national and cross-border payments with a value of almost €534 trillion. TARGET has an 89% share of the total value processed by all large-value Euro payment systems. The daily average number of payments processed in TARGET as a whole, i.e. domestic and cross-border payments taken together, amounted to 326,196 payments, with an average daily value of €2,092 billion. The availability of the system was 99.87%. In 2008, after being replaced by TARGET2, it processed a daily average of 369,966 payments, representing a daily average value of €2,667 billion. TARGET’s share of total large-value payment system traffic in Euro was

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287Ibid.

288Ibid.

289Ibid.

290Ibid.


292Ibid.
90% in value terms and 59% in volume terms. The availability of the system was 99.98% and 99.91% of TARGET payments were processed in less than five minutes. On 22 December 2008 TARGET2 reached a peak of 576,324 transactions, which represents an all-time high for the system (including the original TARGET) since its launch in January 1999. From these explanations above, it shows that after re-designing into SSP, TARGET has become a better system and we can say that TARGET is one of the largest payment systems in the world.

By moving from a decentralized multi-platform into a centralized platform structure, TARGET2 aims to fulfil the harmonized services at EU level, guaranteeing the same level playing field for the banks within the EU. According to TARGET Annual Report 2011 published by ECB, during its years of progression, it effectively met the goals, especially in implementing single monetary policy, it contributed to reducing systemic risk and it helped banks to manage their Euro liquidity at national and cross-border level. Furthermore, TARGET2 provides ancillary systems with a harmonized set of cash settlement services and supports its users with enhanced liquidity management tools. The new generation of TARGET also provides a better integration of Euro liquidity management by making it possible for multi-country banks to further consolidate their internal processes for their treasury activities for Euro.

TARGET2 has the same operating dates and times as the first-generation TARGET system. TARGET2 is also open from 7 a.m. to 6 p.m. CET or ECB time on each of its working days, with a cut-off time of 5 p.m. CET for customer payments. However, the operational day of TARGET2 will be longer than the previous one, starting the new business day on the evening of the previous day.

The Euro-system released the “Information Guide for TARGET2 Users” which aims to provide a standard set of information in order to give their operators a better understanding of the overall functioning of the system and to enable them to make use of it as efficiently as possible. Furthermore, the information guide gives users a clear understanding of the features that are common and/or specific for each country and provides information and measures for abnormal and contingency situations. The Euro-system also released the

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293 Ibid.
294 Ibid.
295 Ibid.
297 Ibid.
298 The night-time window is available from 7.30 p.m. to 6.45 a.m. CET the next day, with a technical maintenance period of three hours between 10 p.m. and 1 a.m. CET. The author does not elaborate on this technical operation in the current dissertation.
“Information guide for TARGET2 pricing” to give a comprehensive overview of the pricing schemes related to TARGET2 operations.\(^{300}\)

2.2 The Minimum Common Features of TARGET

As mentioned above, TARGET ensures the smooth implementation of the single monetary policy, facilitates the efficient functioning of the money market and improves the soundness and efficiency of the large value cross-border transaction in the EU member states.

In order to carry out the services in 1996, the EMI defined the features of TARGET: to harmonize the features of the national RTGS and to smooth its tasks. At the beginning, three features were required by the EMI,\(^{301}\) i.e. (1) the provisions of intraday liquidity; (2) operating hours; and (3) pricing policies.

For intraday liquidity\(^{302}\), which is already implemented in each NCB’s RTGS, this feature is provided by the NCBs of the Euro area with two facilities: fully collateralized intraday overdrafts, and intraday repurchase agreements.

Concerning the operating time, TARGET is open from 7 a.m. until 6 p.m. CET or ECB time. The local RTGS systems may open at an earlier time for processing domestic payments first. This policy to allow the overlap time between TARGET and other payment systems in other regions such as America and the Far East will encourage the business transactions made by credit institutions and central banks worldwide to limit the cross-currency settlement risk. Regarding the relations with other transfer systems, in this case the net settlement systems, they are required to settle in central bank money. The settlement procedures of the net settlement system for cross-border transactions can be done via normal TARGET transfers between the ordinary (RTGS) account of the participating credit institutions or via a special account for the net settlement system within the ESCB. With regard to the TARGET pricing policy, it will be based on the cost recovery principle. It should uphold a level playing field between participants and it should reduce risk policies in payment systems. In the end, it will avoid competitive distortions within Euro area member states.

In 1997, the EMI developed the features in more detail. With regard to the pricing policy, it was decided that the price of domestic and cross-border transfers in Euro should be

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\(^{300}\) These information guides are available and may be seen at the ECB’s and the respective NCB’s website.


\(^{302}\) Intraday Liquidity can be defined as an extended credit facility provided by central bank to participants during the day and reimbursed before the end of the day. Intraday credit to participants needs to be fully collateralized with adequate collateral.
broadly similar, based on volume predicted. The role of the ECB will also be added to perform the following functions:  

“• provide end-of-day and possibly other control procedures for the TARGET system;
• provide settlement services to cross-border large-value net settlement systems;
• process payments for its own account; and
• maintain accounts on behalf of its institutional customers (excluding credit institutions).”

For the provision of settlement services to Euro net settlement systems, it was agreed to use a method for the settlement of the European Banking Association (EBA) clearing system, by opening a central settlement account at the ECB.

In June 2002, the ECB released TARGET’s minimum common performance features of the RTGS within TARGET. The ECB defined more detailed features for the TARGET’s participants. Some additional features such as accounting functions, communication functions, end-of-day procedures, currency conversion and audit trail should abide by the NCBs. Furthermore, at the same time, the ECB also published TARGET Interlinking Specifications and TARGET Interlinking User Requirements for the NCBs.  

With regard to accounting functions, the settlements at the NCBs take place in real time. No new cash management facility is offered to credit institutions with several accounts in the RTGS systems, which means that there is no consolidation of accounts for credit institutions. Regarding communication functions, all RTGS systems transmit settlement and business information in real time, so the transmission structure should be uniform. However, for domestic communication, they can retain or improve their own configuration.

For end-of-day feature, there are three procedures that have to be complied with, namely the end-of-day procedures during a normal business day, during abnormal situations, and during a “disaster” business day. Compliant with currency conversion, the RTGS systems in each NCB must be able to provide the interlinking with payment denominated in Euro, besides their own currency. In the audit trail area, RTGS systems should be able to provide security-relevant chronological documentation so it can be reviewed or the supervisors can access the transaction activities. These features will be updated continuously, depending on the condition and the development of technology and economy in the EU.

Furthermore, the ECB also releases a guideline on TARGET, which has to be complied with those participants who join TARGET. The guideline is published in the

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304 These publications are more technical requirements and the NCBs should also comply with these requirements.
305 Under normal conditions, the transmission time for the Interlinking network will be less than ten seconds for 99% of the traffic, and less than 15 minutes for the remainder.
306 Further explanation of this feature can be seen at the ECB website on TARGET minimum common performance features of RTGS within TARGET.
Official Journal of the European Union and it becomes legally binding to all participants. The national RTGS system should comply with the minimum common features set out by the ECB.\textsuperscript{307}

The author summarizes the minimum common features that the NCBs should comply with, as follows:\textsuperscript{308}

- **Access Criteria.**\textsuperscript{309}
  This is related to the parties that are entitled to become participants. There are direct participants and indirect participants.\textsuperscript{310} The direct participants eligible for the TARGET system are credit institutions established in the EEA and outside the EEA, with some requirements set out in the Guideline.

- **Currency Unit**
  All cross-border payments should be in the Euro currency.

- **Pricing Rules**
  There will be single pricing rules, which have been determined by the Governing Council of the ECB with the reference of cost recovery, transparency, and non-discrimination. The domestic payment should also respect the policy on pricing, set out in the Guideline.

- **Time of Operation**
  This feature is related to the operating days and the hours of operation.\textsuperscript{311}

- **Payment Rules**
  All the payments should be in connection with the monetary policy operations, the settlement of the Euro leg of foreign exchange operations involving the Euro-system, and the settlement of cross-border large-value netting system handling Euro transfers. The rule is called “No funds, No game”. The payments should become irrevocable by the time the sender account is debited to the receiving account.

- **Intraday Credit**
  This is related to the “No funds, No game” rule, whereby each NCB should provide intraday credit to the supervised credit institutions referred to the Guideline.


\textsuperscript{310}Indirect participant is an institution without its own RTGS account which is nevertheless recognized by a national RTGS system and subject to its RTGS rules and which can be directly addressed in TARGET. All transactions of an indirect participant are settled on the account of a direct participant.

\textsuperscript{311}Previously, the author has already discussed this operation time. See sub chapter 2.2.
2.3 The Oversight of TARGET

The Euro-system has the following tasks:312

“• providing payment and securities settlement facilities (TARGET2) and also a mechanism for the cross-border use of collateral (the correspondent central banking model (CCBM));
• overseeing the Euro payment and settlement systems;
• setting standards for securities clearing and settlement systems;
• ensuring an integrated regulatory and oversight framework for securities settlement systems;
• acting as a catalyst for change (i.e. promoting the SEPA initiative).”

As part of their payment system function, central banks monitor developments in the field of payment and settlement systems in order to assess the nature and scale of the risks inherent in these, and to ensure the transparency of the arrangements concerning payment instruments and services.313 As we can see, one of the tasks of the Euro-system is overseeing the Euro payment and settlement systems and TARGET is one of the objects to be overseen according to Article 105(2) of the Treaty and Articles 3 and 22 of the Statute of the ESCB. In January 2001, the Governing Council of the ECB adopted also the G10 report on *Core Principles for Systemically Important Payment Systems* as one of the standards, which the Euro-system must apply when performing its oversight role.314

Why is the oversight of payment system, in this case, the oversight of TARGET important? It is because the payment systems (the TARGET or other SIPS) are major parts of a country’s economic and infrastructure contributing to the economic activity and also the control of monetary systems. Payment systems which facilitate the flow of funds within the EU region, also has some potential risks, such as credit risk, operational risk and settlement risk, when transaction failures occur. Such risks may upturn into a systemic risk, which the risk that the inability of one participant to meet its obligations, will cause other participants to be unable meet their obligations. This will potentially threaten the stability of the financial system.315 The DNB, for example, has two goals related to oversight.316 The first one is preventing a systemic risk to the extent that it may arise from the payment and settlement systems. The second one is promoting the smooth operation of the payment and settlement systems.

315 The ECB Annual Report 2011, pp. 227
As per above explanation, we can see why oversight is important to be implemented for efficiency and safety and for the smooth functioning payment system. Oversight is also important to aim at safeguarding the transmission channel for monetary policy.

The ECB has an iterative process that comprises of the following elements for oversight:317

- **Formulation of the policy stance: setting the general framework, criteria and standards;**
- **Evaluation of compliance with the policy stance: collection and analysis of information on the overseen entity and implementation actions;**
- **Enforcement of the policy stance: inducing the system to take steps to fulfil the criteria and standards. This could be done by using formal regulatory powers or alternatively by moral suasion.**

Oversight responsibilities within the Euro-system are generally entrusted to the national central bank of the country where the system is legally incorporated, so there has been a shared responsibility between the ECB and the NCBs. The ECB is the overseer of European wide large-value payment systems (including TARGET) whereas the NCBs oversee the respective domestic systems.

The previous chapter has already explained the role of the Core Principles Systemically Important Payment System (CPSIPS) and the Principles for Financial Market Infrastructure (PFMI), set out by the BIS. These two principles, have already offered a useful guideline for the central bank’s oversight in improving safe and efficient management of payment systems. Based on Ben Norman and his colleagues, the oversight of payment system does not quantify the risks, because the risks in payment systems can never be precisely quantified.318 With regard to the oversight of TARGET and other payment systems, the author may argue that the risk-based assessment is more required than system-based inspection. The examination of the bank is quite different from the examination of the payment system. The oversight of payment system is a combination between the moral suasion, the assessment and the regulatory acts, because the main purpose of oversight is to protect the functioning of the payment systems. The oversight of payment system is therefore different from banking supervision. Banking supervision involves monitoring individual banks or financial institutions with a view of ensuring their financial stability and, primarily to protect the customers.

The author tries to define that the risk-based assessment for payment systems oversight is by monitoring, identifying, determining the risk, which may affect the system;

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estimating the impact of the risks itself and mitigating the risks. The BIS already set up the principles for assessing the payment system to ease and encourage the design and operation of safer and more efficient systemically important payment systems worldwide. Besides these two principles, every central bank may define its own oversight method to promote the safety and efficiency of its payment systems.

2.4 Business Continuity Plan (BCP) and/or Disaster Recovery Plan (DRP) of TARGET

In any activities in an industry or within an organization, there might be an incident, a disruption or even a threat which can be either from internal or external, such as malfunctioning software caused by a computer virus, a strike, a power outage, a storm or even a terrorist attacks. With regard to the payment systems industry, this clearly shows that it is critically reliant on a resilient payment system infrastructure. It provides an effective prevention and recovery for continuing the business of the organization or the industry. To overcome the problem, it needs what we call a “business continuity plan” and/or “disaster recovery plan”.

In addition, the BCP/DRP needs some arrangements to make it effective. First, it should have scenarios for handling the disruptions. All types of hazards should be carefully anticipated and identified. The dependencies and interdependencies should be cautiously analysed. The role of related parties is also essential for the success of the scenario. Moreover, these scenarios should be well documented. The second BCP arrangement should have, at a minimum, a secondary site, which should not be located close to the primary site. This secondary site should be able to access the current data, which is a critical component of the BCP. Data mirroring or back-up data, is important to be accessible to ensure the business can recommence promptly.

The next arrangement is to identify the staff critical for the running of the BCP. The system operators should minimize the risk by ensuring that all staff members are simultaneously present at the same site. If not, it would be good to have the secondary site located in geographical areas that have a different risk profile operated by different staff. The fourth arrangement is the dependence on third party providers. The system operators should be aware not to depend on a single supplier, for example, merely depend on a single of the operational reliability of telecommunication provider. This is generally critical for payment systems. The Service Level Agreement will be needed to ensure the availability and capability of the service providers’ facilities and resources, especially in the event of a disaster. Therefore, it is recommended to have tests and simulations be organized with the involvement of the recovery service providers.

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319 Business continuity and/or disaster recovery plan can be defined as some processes that help organizations or industry prepare for disruptive events.

320 The author summarizes from the ECB’s Developing BCP.
The last arrangement is the role of the participants. The technical failure of critical participants in the system may induce a systemic risk. It is recommended that participants should have a secondary processing site and this should be part of the technical requirement to access the system.

The ECB, with regard to this issue has prepared a business continuity plan for TARGET. The ECB has learnt from a series of major incidents (e.g. terrorist attack of 911 disaster and other disruptions such as power outages, etc.), to work together to develop implementation guidelines which are applicable to all SIPS and which define the required level of resilience, as well as to establish “good practices” to ensure that such a level is delivered.321

The steps above are similar to the element framework of the ECB and also to other companies that have already prepared the BCP/DRP for their organizations.322 These preventions are applicable to all SIPS operating in the Euro area. The Euro-system already has a set of business continuity expectations with regard to the CPSS Core Principle VII, to be integrated into its oversight policy framework.323

Another important component that should be implemented for the effectiveness of the BCP is to update it continually at certain periods or at any time where there is a major alteration on infrastructure or business procedures, which concern the critical functions of the system. This updating should also be audited by an independent party to make sure that the modifications are already appropriate.

2.5 The Legal Framework of TARGET

As it has been described in the previous sub chapter, since 1 January 1999, the European Central Bank (ECB) has been responsible for conducting monetary policy for the Euro area. The ECB and the NCBs are also entrusted by the Treaty establishing the European Community and by the Statute of the ESCB with the task to facilitate the efficient functioning of money market and to improve the soundness and efficiency of large value cross-border transaction in the EU member states. They designed one of the most efficient and safe payment system known as TARGET and then transformed into TARGET2, which was developed by the Euro-system, the central banking system of the Euro area. There are three Euro-system operators running TARGET i.e. the Deutsche Bundesbank, the Banca d’Italia, and the Banque de France, who jointly provide the SSP for TARGET2 and operate it on behalf of the Euro-system.

322 For example, Bank Indonesia has also the BCP and DRP for the continuity of BI-RTGS.
TARGET has a powerful legal basis supporting its tasks. TARGET is designed by the ECB and the NCBs entrusted by the Treaty and the Statute of the ESCB. The ECB is one of the major supranational institutions of the EU with legal authority on monetary policy and also on the payment system policy. The ECB can make legally binding regulations and decisions. The NCBs shall act in accordance with the regulations and instructions issued by the ECB.

To provide legal certainty, the Euro-system also arranged some regulations governing TARGET and its functions which are laid down in the TARGET Guideline. The TARGET Guideline applies to both the ECB and the NCB participants in the Euro area. It comprises provisions with a number of minimum common features to which all national RTGS system participants or connected to TARGET must comply, arrangements for inter-member State payments through the interlinking system, and the management of TARGET. In 2007, the Euro-system completed the public TARGET2 Guideline. The new Guideline is the basis for the NCBs to establish their TARGET2 component systems, governed by their national legislation.\(^{324}\) The TARGET2 Guideline contains the main legal elements of TARGET2 as well as governance arrangements, and audit rules. It includes the harmonized conditions for participation in TARGET2 to ensure the maximum legal harmonization of the rules relevant to TARGET2 participants in all jurisdictions concerned. The NCBs of the non-Euro area are allowed to connect to TARGET on a condition that they must obey to the rules and procedures referred to above and implement the modifications and specifications appropriate for the non-Euro area NCBs. TARGET Guideline provides a separate agreement for the non-Euro area NCBs.

Compliant with the CPSIPS, with regard to transparency, the ECB published the TARGET Guideline on its website and on the NCBs website.\(^{325}\) Since the commencement of the TARGET system in 1999, the TARGET Guideline has been amended and adjusted a number of times.\(^{326}\) It shows that the alterations of the guideline reflect the growing business and legal developments in the EU.

Besides the TARGET Guideline, the Euro-system also provides a set of rule and procedures in national regulations and/or contractual provisions (national RTGS rules) applicable to each of the national RTGS systems and the ECB Payment Mechanism (EPM).\(^{327}\) Some of the rules are the legal basis for irrevocable and final settlements vis-à-vis the

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325 The document has also been published in the Official Journal of the European Communities.
326 One of the latest adjustments was consolidated in Guideline (ECB/2009/9) of 7 May 2009 (OJ L 123/94, 19.5.2009). This amendment was conditioned by the newly introduced cross-system settlement and in view of their specific institutional nature under Community law are subject to scrutiny of a standard comparable to supervision by competent national authorities.
327 EPM is an integral part of TARGET, which is operated by the ECB and connected to the 15 national systems in exactly the same way as they are connected to one another. See further the ECB website, at https://www.ecb.europa.eu/paym/t2/before/epm/html/index.en.html, last accessed on January 20, 2015.
participants, provided by national law. In addition, the accountabilities of all parties involved, whether as participants or as service providers related to the system, must be obviously defined and set by contract and should be in line with the Guideline.

Besides the TARGET Guideline, there are also the Payment System Directive (PSD) and Settlement Finality Directive (SFD), which make the legal framework for payment services in the EU harmonized. The aim of PSD is to guarantee that cashless payments, including the TARGET system, are as smooth, efficient and also safe and sound as the domestic payments. The PSD consists of authorization requirements, transparency requirements, and rights and obligations. The SFD provides the certainty of protections against the insolvency of a participant in the system, in order to make sure that transactions, which have already been settled in the system, are final and irrevocable, and also to ensure the enforceability of collateral security.328 This Directive purposes to diminish the systemic risk inherent in payment and securities settlement systems and to decrease the disruption caused by the insolvency of a participant in such a system.329 These two directives provide standardization for the construction of an integrated payment throughout the EU. They ought to be transposed into the national law of the EU member states.

Furthermore, the new TARGET2 Guideline also provides the basis on which the NCBs of the eurozone create and design their own TARGET2 participation, in conjunction with their national legislation.330 This new guideline provides harmonize conditions for all participations. These TARGET2 conditions allow the NCBs to implement them in an identical manner, with certain derogations only in the event that national laws require other arrangements.331

From the above description, the author observes that the EU and the ECB (the Euro-system) are already successful in harmonizing the operational legal framework of TARGET to be implemented by all the NCBs of Eurozone. The NCBs must adopt the guideline and other related rules and agreements as the basis for their respective national legislation.

The Treaty and the Statute also provide a legal harmonization clause, which makes TARGET efficient and easy to implement. Article 105 (4) of the EC Treaty (was amended by Article 127(4) (TFEU)) and Article 4 of the Statute state that the ECB shall be consulted on

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328 The Settlement Finality Directive is aimed at reducing the systemic risk associated with participation in payment and securities settlement systems, and in particular the risk linked to the insolvency of a participant in such a system. The Directive applies to payment and securities settlement systems as well as any participant in such system and to collateral security provided in connection with the participation in a system, or operations of the central banks of the Member states in their functions as central banks. See at http://ec.europa.eu/finance/financial-markets/settlement/index_en.htm, last accessed on January 20, 2015.


331 According to the TARGET Annual Report 2011, no national derogations have been identified so far by the NCBs.
any provision and draft regulation in its field of competence; this also includes national rules and regulations in the field of payment systems.  

Before the TARGET Guideline is published, all the Governors of the NCBs of the Eurozone must give their approval. Before their approval is granted, the working groups i.e. The Payment and Settlement Systems Committee (PSSC) and the Legal Committee (LEGCO) whose members are the legal experts from the respective NCBs of the Eurozone, give advises on general payment systems policy including the draft of Guideline. It can be concluded that there is a harmonized co-ordination at the Euro-system level by way of appropriate committees and working groups.

The author also finds that this mechanism and type of legal framework will make it efficient and convenient for the participants involved, especially if conflicts may arise. The standardized and harmonized regulations will ensure certainty of law and enforceability of judgment among the participants. The system and the regulation are made from, by and for themselves.

2.5.1 Dispute Resolution Framework and Applicable Law

Legal risk may also arise in TARGET due to conflict of laws. It may be between the ECB and the NCB and among the NCBs as well. As described above, the systems and the regulations are made by, from, and for the EU member states of the Eurozone; thus, in this regard, the ECB has already anticipated the rule of resolving a dispute, which may arise between the parties.

Article 12 of ECB/2007/2 dated 26 April 2007 states as follow:

1. In the event of a dispute between Euro-system CBs in relation to this Guideline, the affected parties shall seek to settle the dispute in accordance with the Memorandum of Understanding (MoU) on an Intra-ESCB Dispute Settlement Procedure.
2. By derogation from paragraph 1, if a dispute relating to the division of the tasks between Level 2 and Level 3 cannot be settled by agreement between the affected parties, the Governing Council shall resolve the dispute.
3. In the event of a dispute of the type referred to in paragraph 1, the parties’ respective rights and obligations shall primarily be determined by the rules and procedures laid down in this Guideline. In disputes concerning payments between TARGET2 component systems, the law of the member State where the seat of the Euro-

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333 It has been amended by Art.25 ECB/2012/27 dated 5 December 2012, OJ.L 30, 30.1.2013. The content of the clause has remained the same.
system CB of the payee is located shall apply in a supplementary manner, provided that it does not conflict with this Guideline.”

It is clearly stated that if there is any dispute between NCBs, the MoU is used as a reference to settle the dispute. In case it cannot be settled in accordance with the MoU and/or by the agreement made by them, the Governing Council of the ECB shall resolve the dispute.

There is another measure for resolving the dispute concerning the payments between the TARGET2 component systems. If there is a dispute among them, then the law of the member State where the seat of the Euro-system CB of the payee is located shall apply, but it should not conflict with the guideline. As with any dispute regarding contractual obligations between parties residing in different EU member states, the Rome I regulation (Regulation (EC) 593/2008) determines the law that governs the dispute. Article 25(3) ECB/2012/27 stipulates that the law of the EU member state, where the payee resides, is applicable in a supplementary manner. This means that the payee’s law is only applicable to the extent that it does not conflict with the applicable law according to Rome I.

The author observes that in the RTGS system, known as the fund transfer system, the applicable law based on the payee’s law makes sense, since the payee is the beneficiary of the transaction and is regarded as the ‘weaker’ party, because he/she is the party who will incur the damage/loss if the transaction cannot be settled or is delayed. Therefore, the payee should receive some additional comfort. Moreover, the execution usually will be carried out in the place of the person sustaining damage. The description of harmed/loss party will be analysed further in chapter 4.

The author finds that the TARGET operation has a very systematic and harmonized legal framework and structure. First, once again, it is regulated by the Treaty – the highest and the most powerful legislation – agreed by all the Head of Governments of the EU member states. Then, the Statute of the ESCB and the ECB also play an important role for smoothing the TARGET operations. Furthermore, the Governing Council, which consists of all the Governors of the Central Banks of the EU member state of the Eurozone, has the most important role. It provides the guideline to ensure smooth and efficient operations of TARGET. By this legal framework, the legal authority of the ECB in the field of payment system, especially in TARGET has a legal power to all the NCBs of the Eurozone. The ECB also has the power over the NCBs, which did not join the Eurozone. When they want to join TARGET, they should comply with the guideline as well.
In making the provisions or regulations, the Treaty and the Statute already govern the mechanism for the ECB by consulting with the experts in its field of competence.\footnote{Article 105 (4) of the Treaty (was amended by Article 127(4) (TFEU)) and Article 4 of the Statute of the ESCB.} In the ESCB, committees were established by the Governing Council\footnote{Article 9 of the ECB’s Rules and Procedure.} to assist the work of the ECB’s decision-making bodies. The committees consist of experts in their fields. The ESCB committees for the payment system policy are the PSCC and the LEGCO whose members are usually restricted to the staff members of the Eurosystem central banks. They are working together and have quite a long discussion before submitting the draft to the Governing Council to be adopted. The committees try to render the guideline and other related regulations in line with the requirements of the national law as much as possible.\footnote{The ECB’s policy has always been to ensure that its guidelines are compatible with national law.} If TARGET stipulates a regulation related to the monetary policy, then the Monetary Policy Committee (MPC) will also be involved in this working group in order to be in line with the ECB’s monetary policy as well. We can say that in making the regulations of TARGET, all the member states of the Eurozone are at all time involved in the discussion and in the negotiating process, thus the unified and harmonized legal condition can be implemented successfully.

### 2.5.2 The Contractual Agreement Related to TARGET

The ECB guidelines also have been designed to allow the NCBs and their counterparties and between the NCBs, to have other legal arrangement between them. This can be governed either by contracts concluded between the NCBs and their counterparties or by regulatory acts addressed to the counterparties. The arrangements may vary from country to country.

They also have a contractual agreement between the Eurozone TARGET operators – which are represented by the Deutsche Bundesbank – and the NCBs. They call it Service Level Agreement (SLA). SLA will typically have a technical definition, specifying the levels of accessibility, performance, operation, or other attributes of the service. If the dispute arises in relation to the SLA, there is a clause regarding the choice of forum and choice of law, which has been determined, i.e. by going to arbitration applying German Law, the law where the Deutsche Bundesbank and the Headquarters of the ECB is located.\footnote{TARGET is located in Frankfurt, Frankfurt am Main became the seat of the ECB by common accord of the Heads of State or Government of the EU Member states of 29 October 1993. The Deutsche Bundesbank is also located in Frankfurt.}

Article 35.4 of the ESCB Statute states:
“The Court of Justice shall have jurisdiction to give judgment pursuant to any arbitration clause contained in a contract concluded by or on behalf of the ECB, whether that contract be governed by public or private law.”

The same commitment was reaffirmed in Rome I. Article 4 (1(b)) Rome I clearly states as follows:

“A contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence.”

In case the parties of the contracts have not chosen the applicable law, Rome I already determined that the law of the country where the service provider has his habitual residence is applicable. Furthermore, the application of the lex domicilii principle also simplifies the execution of the damage. The ECB/the Eurozone has already prepared the clause of dispute of the SLA in line with the Rome I Regulation.

There is also a contractual arrangement between the respective NCBs and their participants of their own TARGET2 component system. The DNB, for example, has a provision known as Conditions for TARGET2-NL, which has already prescribed the governing law and the jurisdiction with regard to its relationship with the participants. When a dispute arises among them, the competent court is the court of Amsterdam and shall be governed by Dutch Law, in accordance with Article 48 of Conditions for TARGET2-NL:

1. The bilateral relationship between the DNB and participants in TARGET2-NL shall be governed by Dutch Law.
2. Without prejudice to the competence of the Court of Justice of the European Union, any dispute arising from a matter relating to the relationship referred to in Paragraph 1 falls under the exclusive competence of the competent courts of Amsterdam.
3. The place of performance concerning the legal relationship between DNB and the participants shall be Amsterdam.”

In this situation, when a case comes before a court and the main components of the case are local, the prevailing national law will decide the case and usually they use the law of the place of performance.

From the above analysis, the author finds that the ECB and the NCBs in preparing the set of rules and regulations on TARGET have demonstrated that the legal framework for TARGET system was well prepared. It also seems to the author that they also have a good and systematic cooperation by sharing their common desire for

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harmonized legal conditions. Accordingly, they try to harmonize and unify the regulations without hampering the national law of the member states.

3. **Summary**

This chapter describes the background of the ECB and TARGET. The author concludes that the EU has done a tremendous effort in establishing its region and in developing its payment systems project. The EU leaders were strongly committed to achieve their objectives by initiating and establishing the EMU, the EMI, the ECB, and TARGET. The EU had former high-level officers/politicians who also played a big role in providing a proposal or input, such as Mr. Nout Wellink and Mr. Hans Dietrich Genscher, or who became team leaders or committee leaders, such as Mr. Pierre Werner and Mr. Jacques Delors.

Moreover, the EU is also very concerned about having a set of rules (legal basis), and structured bodies to implement its projects. It has implemented treaties such as the Rome Treaty, the Maastricht Treaty (EC Treaty), and the Lisbon Treaty (TEU and TFEU) as legal umbrellas supported by directives and related regulations to be transposed into national laws. The ECB was established by EC Treaty (was amended by TFEU) and has decision-making bodies which played important roles.

In relation to the payment systems, the EU first created TARGET, which was then followed by the retail payment systems (creating the SEPA initiative a decade later). TARGET also has a sound legal basis with provisions on applicable law for disputes; a well-structured body, and clear rules and procedures for its implementation. It also complies with the CP-SIPS and the FMI standards.
CHAPTER 3

THE HISTORY OF ASEAN AND THE AEC

1. The History of ASEAN

1.1 Introduction

ASEAN, a regional organization whose members have mainland of approximately 3,055,000 square kilometres and a total population in 2013 of about 620 million people, is one of the biggest associations and the most reputable organisation in the Asian region and even in the world, and has played an important economic and political role worldwide, especially for its members. The background of ASEAN started alongside the Cold War and in the turmoil transition to independence taking place in many Southeast Asian states. Before the establishment of ASEAN, Southeast Asia had the Association of Southeast Asia (ASA), formed in 1961 by Thailand, the Philippines and the Federation of Malaya under the initiative of the Prime Minister Rahman of Malaya. The war in Vietnam also encouraged the Association to more actively form a new regional body encircling Indonesia and Singapore.

In the early 1980s, the ASEAN integration resembled that of the EU more than that of any integrated group of economies. However, the inter-country differences within ASEAN are far wider than those found within the EU-15. As written above, according to KOF Globalization Index, the level of diversity within ASEAN is considerable.

In the late 1980s, Southeast Asia had changed vastly since its commencement in 1967 and it was indicated that it had regained its regional stability and made remarkable economic development. The change was maintained with the ending of the communist insurgency as well as the pulling out of the Vietnamese troops from Cambodia, followed by the signing of the Cambodian peace pact. With regional stability, prominent economic growth, and intra-region cooperation, ASEAN continued to promote active diplomatic initiatives such as the ASEAN Regional Forum (ARF) and the Asia-Europe Meeting (ASEM) and it also promoted intra-region cooperation as set in the ASEAN Free Trade Area (AFTA) agreement. Situated in the middle of regional stability and prosperity, Vietnam ended its previous confrontation and joined ASEAN as its seventh member on July 28, 1995.

1.2 Scope of ASEAN

As mentioned above, The Association of South East Asian Nations or namely ASEAN was created on August 8, 1967 in Bangkok, by five original Member Countries, i.e. Indonesia, Malaysia, the Philippines, Singapore and Thailand. Brunei Darussalam joined in 1984, followed by Vietnam in 1995, Lao PDR and Myanmar (Burma) in 1997 and last but not least, Cambodia joined in 1999.

It is clear that the ASEAN alliance membership is open for all states in the Southeast Asian region with the same aims, principles and purposes. The ASEAN membership is voluntary in nature. The association embodies the communal will of the nations in Southeast Asia to bond together in friendship and cooperation, and through joint efforts and sacrifices, in the name of peace, freedom, prosperity and future generation.

1.3 The Fundamental Principles of ASEAN

The ASEAN Member Countries have adopted the pursuing fundamental principles in their dealings with one another, as contained in the Treaty of Amity and Cooperation in Southeast Asia (TAC), signed on February 24, 1976.

\[ \text{"a. mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;}
\]

\[ \text{b. the right of every State to lead its national existence free from external interference, subversion or coercion;}
\]

\[ \text{c. non-interference in the internal affairs of one another;}
\]

\[ \text{d. settlement of differences or disputes by peaceful manner;}
\]

\[ \text{e. renunciation of the threat or use of force; and}
\]

\[ \text{f. effective cooperation among themselves."}
\]

From the principles above, the author will observe only two principles which will be discussed in the next sub chapter i.e. the Principle of Non-Intervention and Settlement of Differences or Disputes by Peaceful Manner.

1.3.1 The ASEAN Principle of Non-Intervention

This principle seems to be a source of misperception for some intellectuals. Jürgen Rüland debates that “ASEAN’s collective identity crystallized in the revered principle of non-intervention”. He also thought that non-intervention was little more than a pious myth. He refers to the example of: (1) Malaysian and Indonesian protests against Myanmar’s expulsion of the Rohingya Muslims to Bangladesh; (2) the critical remarks of Singaporean Senior Minister Lee Kuan Yew during a visit to

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342 See article 2 of the Association’s Treaty of Amity and Cooperation.

the Philippines, linking the country’s unruly democratic system to economic stagnation, the provision of sanctuary to Muslim rebels in the Philippines by Sabah’s chief minister Tun Mustapha; and (3) Indonesian pressure on the Philippines to cancel an NGO conference on East Timor.  

Increasingly, ASEAN is a vehicle for Southeast Asian nations to resolve problems through the “ASEAN Way” of informal consensus-based and confidence-building efforts rather than through binding commitments or agreements.  

It is the underlying cultural-based beliefs governing the ASEAN actions, which make up the real “ASEAN Way”. In traditional terms, the manner of politics found in Southeast Asia can, to a large extent, be considered as personal, informal and non-contractual. It can be interpreted that the “ASEAN Way” is more indirect than straight regarding the issues and applies non-confrontational approach by seeking support from other nations. One of the examples is when Thailand’s foreign minister, Siddhi Savetsila, the ASEAN standing committee chairman, visited Washington D.C to get support for a proposition.  

Essentially, it is not difficult to understand why this principle was used by ASEAN in 1967. The member countries are divided by historical, religious, cultural, political and economic differences. There are some obvious ethno-religious divisions, such as Islam (Indonesia/Malaysia), Buddhist (Thailand, Singapore), and Christian (Philippines). At that time, the political situation was unsteady and the economy was fragile. Under such circumstances, ASEAN could never have survived if the members had failed to adhere to the non-intervention principle with a rational degree of consistency. As Holsti observes, if non-intervention, sovereignty, and the legal equality of states “were not observed with reasonable consistency, the structure of the system and the nature of interstate relations would change radically”.  

1.3.2 The ASEAN Principle of Settlement of Differences in Peaceful Manner  

As we know, ASEAN is an intergovernmental organization, where the policy makers are indeed the heads of states and governments of the member states. The ten members have an equal vote in making decisions. However, decision-making was strictly by consensus. To settle dissimilarities among members, ASEAN relied on close personal ties at official, ministerial and heads of government levels at post

344 Ibid pp. 440.  
347 Ibid, pp. 115.  
348 Ibid, pp.117.  
meeting entertainment sessions, than on formal institutions and treaties. This enabled the resolution of differences among the elite, lessening the need to resort to various forms of burden for achieving national goals and stability. The Declaration of ASEAN Concord (1976) clearly states that:

“The stability of each member state and that of the ASEAN region is an essential contribution to international peace and security... member states, in the spirit of ASEAN solidarity, shall rely exclusively on peaceful processes in the settlement of intra-regional differences.”

In addition, the mediation measures have often sought to solve the conflicts between neighbouring members. In late 1986, the Indonesian Leader, Soeharto, organized an official visit to Malaysia for the southern capital Johor Baru, then crossed the causeway to Singapore, in a gesture designed to ease conflict between these two countries after they had fallen out over the visit to Singapore by the Israeli President. In February the same year, five foreign ministers called for a ‘peaceful resolution’ to the conflict with increasing concern over the trend of events following the presidential election in the Philippines, noting:

“A critical situation has emerged which portends bloodshed and civil war. The crisis can be resolved without widespread carnage and political turmoil. We call on all parties to restore national unity and solidarity so as to maintain national resilience. There is still time to act with restraint and bring about peaceful resolution. We hope that all Filipino leaders will join efforts to pave the way for a peaceful solution to the crisis.”

In Chapter III of the Treaty (TAC), it was also mentioned that the Association’s Leaders agreed to strengthen economic development and mutual assistance. Based on this Treaty, the members shall adopt appropriate regional strategies for economic development to intensify economic cooperation. A number of economic reasons can be advanced to explain the relative stagnancy of the intra-regional trade in the past:

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352 Ibid.
354 See article 7, chapter III of the Association’s Treaty of Amity and Cooperation.
“(1) The existing trade and production patterns of ASEAN have allowed only limited absorptive capacity for each other’s major exports like rubber, tin,....

(2) The ASEAN economies have almost exhausted all their commercial capacities in responding to the large and growing export market of developed countries during the past two decades.

(3) The import-substitution policies together with the balance of payments difficulties among some ASEAN countries have resulted in certain policies which are inherently biased against regional trade: for example, high priority is given to imports of capital and intermediate goods which are usually supplied by the developed countries.

(4) Past foreign aid and loans from developed countries have often been tied to imports from donor countries.”

Ultimately, significant growth of intra-regional trade depends on the appropriate restructuring of the existing trade policies, currently pursued by the individual members, such as liberalizing the present intra-regional trade arrangements, for which the leaders agreed to make a treaty in February 1976.

The author thinks that the Treaty became the foundation and a turning point for the economic integration regulation for ASEAN. The Treaty also became a binding rule for the ASEAN member states for achieving economic development in the future.

1.4 The Objectives and Purposes of ASEAN

ASEAN’s objective stated in the ASEAN Declaration in Bangkok was as follows:356

“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;

2. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of the United Nations Charter;

3. To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;

4. To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;

5. To collaborate more effectively for the greater utilization of their agriculture and industries, the expansion of their trade, including the study of the problems of international commodity trade, the improvement of their transportation and communications facilities and the raising of the living standards of their peoples;

6. To promote South-East Asian studies;

7. To maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.

These objectives and purposes have been drafted based on the existence of mutual interests and common problems between member countries, and the need to further strengthen the bonds of regional solidarity and cooperation. To achieve these objectives and purposes, a standing committee is needed as well as Ad-Hoc and Permanent Committees of specialists and officials on specific subjects. To support the work of ASEAN, the Permanent Secretariat was established in February 1976 due to the increasing demands of the ASEAN members for a central administrative organ to provide the efficiency in the coordination of ASEAN’s projects and activities.\(^{357}\)

The Joint Communique Meeting in 1976 and 1977 also emphasized on the desire of the ASEAN countries to develop and promote peaceful and mutually beneficial relations with all countries in the region, including Cambodia, Lao PDR and Vietnam,\(^{358}\) and also welcomed and recommended the decision of the UN related to the admission of Vietnam as a member of the organization.\(^{359}\) One issue to be underlined from the results of this meeting is the recognition of the private sectors, which could play a major role in supplementing the efforts of the ASEAN Governments towards achieving greater regional cooperation.\(^{360}\) This recognition shows that the private sectors have a key role to support the realization of the ASEAN projects, and therefore, ASEAN encouraged the active participation of non-governmental organizations in ASEAN activities.


\(^{359}\)Ibid point 7.

\(^{360}\)See at http://www.asean.org/communities/asean-political-security-community/item/joint-communique-of-the-ninth-asean-ministerial-meeting-manila-24-26-june-1976, last accessed on January 20, 2015. In This meeting, ASEAN recognized the contribution of the private sector to the realization of ASEAN projects and programs. The private sectors proof themselves by designing regional strategies and initiatives, and also in identifying problems in realizing regional integration as the foundation for the AEC, see at http://www.asean.org/communities/asean-economic-community/category/public-private-sector-engagements, last accessed on January 20, 2015. One of the examples is: joint forces to promote sustainable fisheries and aquaculture for long-term food security.
The involvement of the private sector was once again stated in the Manila Declaration on December 15, 1987 as an element which was playing an increasing role in the economic development and in the intra-ASEAN cooperation. For economic development, non-state actors are more needed since they are the players in the industries who know their respective fields better than the states. The heads of the ASEAN government realize the need to involve the private sectors, known also as non-state actors, and make them become a part of the economic development in the region. The influence of non-state actors in the post–cold war era has been one of the leading factors in international politics, not only in ASEAN, but also in the EU and other region states. The role of non-state actors is one of the important parts of this dissertation but it will not be discussed in this section in order to avoid repetition.

In the late 1980’s, the original ASEAN members like Thailand, Singapore and Malaysia wanted to deepen the ASEAN economic integration. It was a former Thai Prime Minister Anand Panyarachun who formally proposed in 1991, with the encouragement and support of Singapore’s and Malaysia’s prime minister, that ASEAN enter into a free trade area, thus initiating the current stage of regional economic integration. From that moment and onward, Singapore seems to have taken the lead initiative of the ASEAN Economic Community integration and keeps stressing and reminding members, especially the new ones, of the commitment on regional economic integration, by suggesting the proposal called the Initiative for ASEAN Integration (IAI) in 2000, while Indonesia, to balance off Singapore, leads with its idea of an ASEAN Security Community. Nevertheless, according to Severino, Indonesia seems to be the best member as a leadership in the escort heading towards an ASEAN economic integration, because Indonesia’s leadership cannot be said to be self-serving. However, Indonesia does not seem to be confident of its ability to be competitive even within ASEAN – whether for investments or for markets.

The ASEAN Vision 2020 was firstly adopted on 15 December 1997 in Kuala Lumpur by the leaders at the 30th Anniversary of ASEAN. This is the ASEAN Vision on the region as a concert of Southeast Asian nations, outward-looking, living in peace, striving for stability and prosperity, bonded together in partnership, in dynamic development, and in a community of caring societies. In this summit, the Treaty Amity became fully functioning as a binding

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363Indonesia particularly led the drafting of the Plan of Action for the ASEAN Security Community on the regular meeting in Jakarta in June 2004 and then the leaders adopted in Vientiane Summit in November 2004.
364Rodolfo C. Severino, “Southeast ASIA In Search of an ASEAN Community”. Ibid., pp. 31.
365Ibid., Severino further states that “it depends on President Susilo Bambang Yudhoyono whether Indonesia can lead ASEAN on the road to regional economic integration, this time within the more constraining conditions of democracy and despite enormous domestic economic difficulties.”
code of conduct for the governments and peoples, to which other states with interests in the region adhere.\textsuperscript{368} After The ASEAN 2020, known as the ASEAN Community, had been declared, and to welcome the ASEAN vision 2020, in 2003 the ASEAN leaders committed to what was known as Bali Concord II.\textsuperscript{369} It established three pillars to realize the ASEAN Vision 2020. In this summit, the term of the ASEAN Economic Community (AEC) was for the first time announced, and in addition to the AEC, the ASEAN Security Community (ASC) and the ASEAN Socio-Cultural Community (ASCC) were the other two integral pillars of the envisaged the ASEAN Community.\textsuperscript{370} This summit was also a big step towards transformation and integration of the economy, socio-culture and security among the member states. Successively, the summit was followed by the ASEAN Economic Ministers Meeting (AEM) in August 2006, which developed a single and coherent blueprint for advancing the AEC by classifying the characteristics and elements of the AEC by 2015 in line with the Bali Concord II.

At the 12\textsuperscript{th} ASEAN Summit, when the Cebu Declaration 2007 was signed, the ASEAN Heads of State and/or Government Member Countries affirmed to accelerate the establishment of the ASEAN Community by 2015.\textsuperscript{371} The AEC as a second pillar of ASEAN Community shall be the ultimate goal of regional economic integration schemes. Its goal is to create a stable, prosperous, and highly competitive ASEAN economic region, in which there is free flow of goods, services, investment, skilled labour, and a freer flow of capital, equitable economic development, and reduced poverty and socio-economic disparities by the year of 2020.\textsuperscript{372} The topic of the AEC will be discussed in the following part of this chapter.

Some efforts related to economic cooperation had been prepared before the setting up of the AEC, such as implementation of Hanoi Plan of Action whose main purposes were consolidating and strengthening the economic fundamentals of the Member Countries.

These are ten elements that are to be fulfilled in order to achieve the specific targets. They are recapitulated as follows:\textsuperscript{373}

1.  \textit{Strengthen Macroeconomic and Financial Cooperation}

Some measures that are to be noted by the author are the strengthening of the financial systems by adopting and implementing sound international financial

\textsuperscript{368}\textit{Ibid.}
\textsuperscript{370}Kementerian Luar Negeri RI, “Cetak Biru Komunitas Ekonomi ASEAN (ASEAN Economic Community Blueprint)”, \textit{Direktorat Jenderal Kerja Sama ASEAN}, 2010, pp. 5.
\textsuperscript{372}See Declaration of ASEAN Concord II (Bali Concord II) point B.1.
practices and standards and the developing of the ASEAN capital markets. One of these programs is to facilitate clearing and settlement systems within ASEAN.374

2. **Enhance Greater Economic Integration**

Some points to be underlined are the need to accelerate the implementation of the ASEAN Free Trade Area (AFTA), inter alia, by creating trade liberalization and customs harmonization. The Framework Agreement on the ASEAN Investment Area (AIA) is implemented to enhance the competitiveness of the region and to attract higher and sustainable levels of direct investment flows into and within ASEAN. The program has its objectives of Narrowing the Development Gap (NDG) and accelerating economic integration of the newer members of ASEAN (Cambodia, Lao PDR, Myanmar and Vietnam, known as CLMV).375 It aims also to realize a free and open investment regime through cooperation and facilitation, promotion and awareness.376 One more important issue that should be observed from this aspect is the encouragement of electronic commerce i.e. first, the creation of policy and legislative environment to facilitate cross-border electronic commerce, to ensure the coordination and adoption of a framework and standards for cross-border electronic commerce in line with the international standards and practices. Secondly, to encourage technical cooperation and technology transfer among member states in the development of electronic commerce infrastructure, applications and services.377 This point becomes a basic foundation for the author to discuss further on the issues of the payment system integration.

3. **Promote Science and Technology Development and Develop Information Technology Infrastructure**

There are two points that should come first to empower and protect the ASEAN’s innovation of technology. First, is the establishment of the ASEAN Information Infrastructure (AII) by making an agreement on the design, standardization, inter-connection, and inter-operability of Information Technology system. Secondly, is to intensify research and development in applications of strategic and enabling technology.378

4. **Promote Social Development and Address the Social Impact of the Financial and Economic Crisis**

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374*Ibid.*, point 1.2 and 1.5.7.
375See “Initiative for ASEAN Integration (IAI) and Narrowing the Development Gap (NDG)”, at http://www.asean.org/communities/asean-economic-community/category/initiative-for-asean-integration-and-narrowing-the-development-gap, last accessed on January 20, 2015. NDG in ASEAN refers to reducing various forms of disparities within ASEAN as well as between ASEAN and other parts of the world where some pockets of underdevelopment persist.
The inspiring programs shall use the ASEAN foundation: (1) to support activities and social development programs aimed at addressing issues of unequal economic development, poverty and socio-economic disparity; and (2) to strengthen the ASEAN collaboration in combating trafficking of and crimes against women and children; and (3) also to protect all human rights and fundamental freedoms of all peoples in accordance with the Charter of the United Nations, the Universal Declaration of Human Rights and the Vienna Declaration and Program of Action.\footnote{Ibid., point 4.3, 4.5 and 4.8.}

5. Promote Human Resource Development

The interesting programs in this element are the implementation of the ASEAN Work Program on Informal Sector Development which provide opportunities for self-employment and entrepreneurship and the program for out of school youth such as skill training and education for employment.

6. Protect the Environment and Promote Sustainable Development

The programs aim: (1) to establish the ASEAN Regional Research Centre and Training Centre for Land and Forest Fire Management; (2) to implement the ASEAN regional water conservation program; and (3) to protect the ASEAN Heritage Parks and Reserves; and lastly (4) to enhance regional efforts in addressing climate change.

7. Strengthen Regional Peace and Security

The formulation of rules and procedures for the operations of the High Council as envisioned in the TAC and promoting efforts to establish a regional code of conduct in the South China Sea among the parties directly concerned\footnote{Ibid., point 7.5 and 7.16.} are programs which the author finds interesting as they can be used as an example for the formulation of the procedures of implementing the payment system integration.

8. Enhance ASEAN’s Role as an Effective Force for Peace, Justice, and Moderation in the Asia-Pacific and in the World

Maintaining ASEAN’s chairmanship in the ASEAN Regional Forum (ARF)\footnote{The ASEAN Regional Forum (ARF) is a formal, official, multilateral dialogue in Asia Pacific region. ARF objectives are to foster dialogue and consultation, and promote confidence-building and preventive diplomacy in the Asia-Pacific region, at http://www.asean.org/3530.htm, last accessed on January 20, 2015.} process and enhancing consultation and coordination of the ASEAN positions at the United Nations (UN) and other international fora are programs that should be conserved in order to be able to continue to interact with the outside world of the ASEAN region to bring peace. In an attempt to bring sustainable peace to the
world, ASEAN and the United Nations (UN) are scheduled to meet to discuss, among other issues, conflict resolution.382

9. **Promote ASEAN Awareness and its Standing in the International Community**

One of the programs that need continuity to raise awareness among the ASEAN member states is developing linkages with the mass media networks and websites on key areas of the ASEAN cooperation in order to disseminate regular and timely information on ASEAN. One of the implementation methods for spreading awareness among the ASEAN community was initiated by Indonesia’s foreign ministry by setting up an online blog for raising public awareness on the issues of the ASEAN Community 2015.383

10. **Improve ASEAN’s Structures and Mechanisms**

Two programs related to this dissertation to be further discussed are reviewing ASEAN’s overall organizational structure in order to further improve its efficiency and effectiveness, taking into account the expansion of the ASEAN activities; the enlargement of the ASEAN membership; and the regional situation as well as reviewing the role, functions and capacity of the ASEAN secretariat to meet the increasing demands of ASEAN and support the implementation of the Hanoi Plan of Action. These programs also meet the AEC agenda, which needs an organizational structure and mechanism to fulfil the ASEAN’s programs in the future. Since the payment system integration is also part of this Action Plan and has its own characteristic and infrastructure, the possibility of reviewing the ASEAN’s structures and mechanisms related to payment systems is open for discussion by these programs. The characteristics, structure and mechanism of payment system will be discussed in another chapter.

Setting these 10 (ten) programs of the Hanoi plan of action was the first stage in a series of actions to help ASEAN reach its goals. This plan of action will also become the foundation of economic cooperation and integration within the ASEAN member states. The author honours the idea of the ASEAN leaders who have a sense of willingness and concern to always be open to reforms by setting up this action plan.

1.5 **External Relations of ASEAN**

In order to strengthen the region and to secure the recognition and the respect for ASEAN, the member countries need to broaden the areas of cooperation with other countries. In this regard, the ASEAN leaders developed a close partnership with the countries and

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organizations with an interest in Southeast Asia as part of ASEAN’s strategy to remain in the driver’s seat in the regional developments and in the creation of a network of economic agreements in the region.

These are the following countries/fora of cooperation with ASEAN:

1.5.1 Fukuda (Japan) Relation

The first partnership of ASEAN started with Japan in 1973. In 1977, the Prime Minister Takeo Fukuda, with his famous doctrine called “Fukuda Doctrine” reassured Japan’s policy to support the national development in the ASEAN countries. Three principles were announced in Manila:

“- Japan rejects the role of a military power;
- Japan will do its best to consolidate the relationship of mutual confidence and trust based on "heart-to-heart" understanding; and
- Japan will an equal partner of ASEAN, while attempting to foster mutual understanding with Indochina.”

1.5.2 The Republic of Korea

The Republic of Korea is ASEAN’s second dialogue partnership. It was firstly cooperated in 1989, covering the trade, investment and tourism area. Subsequently, they upgraded to a full dialogue partners in 1991 on the 24th ASEAN Ministerial Meeting (AMM) in Kuala Lumpur.

1.5.3 China

The relationship with China started in 1991 on the 24th AMM when the host invited China as a guest, and upon identifying mutual interest, China became a full dialogue partner at the 29th AMM in Jakarta on 20-21 July 1996.

1.5.4 Asia-Pacific Economic Cooperation (APEC)

APEC is a forum of 21 member economies that seeks to promote free trade and economic cooperation throughout the Asia-Pacific region. ASEAN collaborated with Australia in establishing APEC in 1989 in response to the growing interdependence

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387 APEC consists of 21 member economies: Australia, Brunei Darussalam, Canada, Chile, China, Chinese Taipei, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Thailand, United States, and Vietnam.
of the Asia-Pacific economies and the arrival of regional economic blocs in other parts of the world such as the European Union. The APEC Secretariat is located in Singapore, to prove that ASEAN fully and actively supports the APEC establishment. APEC is the premier forum for facilitating economic growth and cooperation as well as trade and investment in the Asia-Pacific region.\footnote{See APEC website, “What is Asia-Pacific Economic Cooperation?”}, at http://www.apec.org/About-Us/About-APEC.aspx, last accessed on January 20, 2015.

1.5.5 ASEAN Free Trade Agreement (AFTA)

At the 2\textsuperscript{nd} ASEAN Summit in 1992, the ASEAN leaders recommended the idea of AFTA\footnote{See also ASEAN website, “Towards an East Asia Community: The Journey Has Begun”, by Termsak Chalermpalanupap, at http://www.asean.org/resources/item/towards-an-east-asia-community-the-journey-has-begun-by-termsak-chalermpalanupap, last accessed on January 20, 2015.} by signing the Framework Agreement on Enhancing the ASEAN Economic Cooperation. This is a wide-ranging program of tariff reduction in the region to attract foreign direct investment to ASEAN. The AFTA is formed to increase the ASEAN region’s competitive advantages as a production base geared for the world market. Such creation is also to compete with the existing regional bloc such as the EU and the North American Free Trade Agreement (NAFTA). This is a common reaction since globalization also influences the Southeast Asian region. AFTA has the mechanism to achieve its goals by a so-called The Common Effective Preferential Tariff (CEPT), which only applies to goods originating within ASEAN.

1.5.6 The European Union (EU)

The ASEAN-European Union (EU)\footnote{See “Overview of ASEAN-EU Dialogue Relations” point 1, at http://www.asean.org/23216.htm, last accessed on January 20, 2015.} dialogue relations were officially held on the 10\textsuperscript{th} ASEAN Foreign Ministers Meeting (AMM) in July 1977. They agreed on ASEAN’s formal cooperation and relationship with the European Economic Community (EEC), which included the Council of Ministers of the EEC, the Permanent Representative of the EEC countries and the EEC Commission.

1.6 The ASEAN Charter

The “ASEAN Way” is the traditional principle of non-interference, meaning that governments can endeavour to influence each other’s conduct by creating diplomatic channels or informal consultation. Globalization in the region, plus the economic crisis in the late 1990’s, has devastated most of the ASEAN members’ economy. This is well known as “the ASEAN Financial Crisis 1997”. The Asian financial crisis started with the devaluation of Thailand’s Bath, which took place on July 2, 1997, and followed by other regional members,
like Indonesia, Malaysia, the Philippines, and, to a lesser extent, Singapore. These challenges urged ASEAN to revitalize itself. The entry of Cambodia, Vietnam, Lao PDR and Myanmar as new members also created an imbalance of economies between the members. The Economic gap development has changed dramatically and need more efficient and structured mechanism to resolve. To answer the imbalance of economies between the members, the Leaders agreed to launch the IAI program, which provides guidance to sharpen the focus of collective efforts in ASEAN to narrow the development gap between ASEAN's older and newer members (CLMV). These issues should have been a critical moment for the ASEAN members to take a closer look again at the Association’s structure that needs to be adjusted. The widening tasks and the growing complexity of economic issues would make more policy coordination and harmonization an inevitable consequence.

There are differences among the members, which require more attention, as they may not have a common political conception of the ASEAN Way since the crisis struck the ASEAN region, such as Myanmar and Lao PDR which still emphasize the traditional non-interference principle. Conversely, the other members such as Vietnam and Malaysia have started to focus on methods of work, developing mechanism of coordination and strengthening of the consolidation and cooperation among the members for the future in order to resolve outstanding issues. On the other side, the members states administrations are totally different as well, for instance, Indonesia and the Philippines are a republic, Malaysia is a constitutional monarchy while Vietnam and Lao PDR are communist states. The members also have a wide gap of economics. According to World Bank data in 2013, Singapore for example, has a GDP per capita of US$55.182,8, while Cambodia has a GDP per capita of US$1.006,8.

These differences within the ASEAN member states show that ASEAN needs a reform to fulfill the needs of improvement in the future. Globalization requires ASEAN to be more flexible and forward thinking to meet the challenges. The author realizes that it is not an easy

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392 As mentioned above, there were a politic and economic gaps between the old members and the new members.

393 See the Opening Remarks of Prime Minister and Senior General, Union of Myanmar at the 6th ASEAN Summit in Hanoi on December 15, 1998 in par.6, at http://www.asean.org/8740.htm and see also the Opening Remarks of Prime Minister of Lao People’s Democratic Republic at the same summit in par 8, at http://www.asean.org/8742.htm, last accessed on January 20, 2015.

394 See the Opening Remarks of Prime Minister of Vietnam at the 6th ASEAN Summit in Hanoi in par.10 and 19, at http://www.asean.org/8749.htm and see also the Opening Remarks of Prime Minister of Malaysia at the same summit in point 12 and 14, at http://www.asean.org/8741.htm, last accessed on January 20, 2015.

395 See the World Bank Data by country, at http://data.worldbank.org/indicator/NY.GDP.PCAP.CD, last accessed on January 20, 2015. GDP per capita is gross domestic product divided by midyear population. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Other ratio indicators that can be measured to show the economic gap i.e. DSR (debt to service ratio), debt to GDP ratio, current account deficit to GDP ratio. These ratio indicators are not intended to elaborate further.
task for the ASEAN member states to amend the principles, since these principles represent its character and identity; in the meantime, globalization indeed needs such movements. The ASEAN community integration would entail a modification at the “ASEAN Way”, since the global economic powers would continue to supersede the conventional approach.

Despite these vast differences and massive economic and political transformation occurring in the ASEAN region at that time, the ASEAN leaders continued to search the way to anticipate forthcoming issues. Four decades later since the establishment of ASEAN, in November 2007, the ASEAN leaders decided to determine a charter known as the ASEAN Charter.396 This Charter was a breakthrough constitutional manuscript for ASEAN. Its purpose was to strengthen democracy, develop good governance, and foster the rule of law and human rights. Jasudasen says that the Charter provides ASEAN with a clear legal framework after more than forty years of gradual and comfortable institutionalization.397 He also states that the Charter also codifies ASEAN’s well-established norms for inter-state conduct and also formally accords ASEAN a legal personality, which establishes its capacity to join other international organizations and gatherings on its own behalf and gives the right to sue and be sued.

The announcement of the ASEAN charter also attracted a lot of attention on the regionalism in Southeast Asia not only among many scholars and analysts, but also among civil society organizations (CSOs) and non-governmental organizations (NGOs). The breakthrough from the ASEAN officials was the involvement of CSOs in the drafting of the Charter. A series of consultative meetings was done among them. The involvement of non-state actors was an inevitable part in supporting the governments to create and develop ASEAN to achieve its objectives.

The ASEAN Secretariat noted that: “For the first time after 40 years of regional organization, the ASEAN member states have codified organic Southeast Asian diplomacy and listed key principles and purposes of ASEAN.”398 This Charter has fundamentally set up the legal and institutional framework of ASEAN. In addition, the ASEAN Secretary-General, Mr. Ong Keng Yong affirmed that the Charter would serve the organization as follows:399

“(1) Formally accord ASEAN Legal personality,
(2) Establish greater institutional accountability and compliance system, and
(3) Reinforce the perception of ASEAN as a serious regional player in the future of the Asia-Pacific region.”

397 This statement addressed by T. Jasudasen, Singapore Ambassador to Malaysia, before the ASEAN Law Association of Malaysia, on March 9, 2010 in Kuala Lumpur.
399 Ibid.
With the Charter underlying its functioning, ASEAN has a legal personality, therefore is able to represent its member states to play officially in international forums. Moreover, the charter also makes the organization more useful by providing a legal framework for incorporating the ASEAN decrees, and treaties into the national legislation of member states. By virtue of this declaration, ASEAN is now governed by a rule-based regime for effective implementation of the various economic commitments.

Furthermore, the Charter also outlined the institutional structure of the association and created new structures. Besides having an ASEAN Human Rights Body, the Charter has also formed the relationship between each of the institutions and explained their decision-making processes. The Human Rights Body is a promising body, but it did not go far enough in its operation, due to the absence of provisions and sanctions of penalizing mechanism on the infringement of norms. This is because of the decision-making process which takes place by consultation and consensus, is working on the lowest common denominator while the non-interference principles remain unchanged. The Charter still purely contains divergent views of the conceptions. The older member states saw that the “ASEAN Way” needs to be reformed to facilitate cooperation, while the new members still regard it as a norm of non-interference.

Indeed, the Charter preserves the existing infrastructure for economic integration by having the ASEAN Economic Community Council and the Dispute Settlement Mechanism. Despite its limitations, the Charter can be utilized by the ASEAN members and still provide the opportunities for a change.

2. The Role of the ASEAN Economic Community (AEC)

Today, ASEAN tends to be seen very much through the lens of economics — measuring its potential to provide a common or single market for its ten countries. This is similar to the events in Europe in the process of formation of the European Union. The outcome demonstrates that ASEAN tends to strengthen the economy. ASEAN as an organization has become more and more focused on economics and specifically on trade

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400 See ASEAN Charter Art 3.
401 Ibid., Art 2.2(n).
402 Ibid., chapter IV.
403 Ibid., Art 14.
404 Ibid., Art 20.
405 Ibid., Art 9(1).
406 Ibid., Art 24.
407 Ibid., Art 48.
policy. This sub chapter will describe the background of the establishment of the AEC, its objectives and challenges.

2.1 The Declaration of the AEC

The AEC is a concept proposed in the Declaration of the ASEAN Concord II (The Bali Concord II) in Bali, Indonesia, which took place in October 2003. This concept became one of the pillars of the ASEAN vision. The Deputy Secretary General for the ASEAN Economic Community, Pushpanathan, says that the readiness of ASEAN for community building was clearly reflected by the signing of the ASEAN Charter in 2007 and later by its ratification in 2008. At the 11th ASEAN Summit in December 2005, the ASEAN Leaders discussed the acceleration of the AEC implementation from 2020 to 2015 and requested the respective ministers and senior officials to study all relevant possibilities. Subsequently, the 9th High Level Task Force (HLTF) Meeting on the ASEAN Economic Integration in Singapore discussed and recommended it to the ASEAN Economic Ministers (AEM). Thus the ASEAN Secretariat was tasked to develop a single and coherent blueprint for advancing the AEC by identifying the characteristics and elements of the AEC by 2015 consistent with the Bali Concord II, with clear targets and timelines for implementing various measures and pre-agreed flexibilities for the interests of Cambodia, Lao PDR, Myanmar, Vietnam and other concerned member countries. The Leaders, who were behind the idea of economic community, proposed a deeper economic integration. This idea was reinforced by the plan of the ASEAN Economic Community which is to establish ASEAN as a single market and production base, turning the diversity of characteristics in the region into opportunities for business complementation and making ASEAN a more dynamic and stronger segment of the global supply chain.

The reasons behind the decision to create the AEC are as follows:

"a. The desire to create a comprehensive post-AFTA agenda;


409 Ibid, pp. 224.
412 Ibid.
413 ASEAN Secretariat, Declaration of ASEAN Concord II, paragraph B3.
b. The perceived need to deepen economic integration within ASEAN given the new international commercial environment, especially the dominance of free-trade areas (FTAs);

c. Given this environment, the possibility that bilateral FTAs could actually jeopardize ASEAN integration, as all members were free to pursue their own commercial policy agenda; and

d. The recognition since the 1997 Asian financial crisis that cooperation in both real and financial sectors must be extended concomitantly, and that free flows of skilled labour would be required to do this.”

In a sense, the ASEAN process towards realizing the AEC is more like the European Union’s (EU). The stark and important difference, however, is that the EU’s integration process is driven by its strong regional institutions, which ASEAN still needs to build.415 The AEC is the main objective of economic integration.416

The AEC Blueprint was adopted in 2007 and it serves as a comprehensive and coherent master plan for building the economic community.417 The Implementation Plan 2015 seeks to achieve the goals of the AEC Blueprint 2015 by offering a comprehensive set of strategic initiatives and by formulating specific implementation actions and objectives.418 In order to build such a market in ASEAN, there are essentially two closely related approaches:419

“1. To focus on full harmonization of domestic laws, regulations and operations in order to facilitate cross-border access based primarily on International principles, standards and best practices. This is supported by mutual recognition in any sectors that are not subject to harmonization and by liberalization measures that that will ensure an absence of national restrictions on access. This is broadly the approach taken in the European Union.

2. Another approach is to create enabling conditions for access with broad harmonization, and supported by mutual recognition and a greater freedom

415 Ibid.
417 Ibid.
418 See ASEAN Capital Markets Forum (ACMF), The Implementation Plan, at http://www.theacmf.org/ACMF/report/ImplementationPlan.pdf, last accessed on January 20, 2015. Further, The initiatives cover three broad themes: Creating an enabling environment for regional integration, creating the market infrastructure and regionally focused products and intermediaries, and strengthening the implementation process. Thus, The AEC blueprint 2015 pertaining to capital markets seeks to achieve significant progress in building a regionally integrated market, where within the region: 1) Capital can move freely; 2) issuers are free to raise capital anywhere; and 3) investors can invest anywhere. In such a market anyone would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries being able to provide services through ASEAN based on home country approval.
419 Sjamsul Arifin, et al., Opcit., pp.2
for capital movements. This is the vision and the approach that is implicit in the AEC Blueprint 2015.”

These two approaches are complementary rather than alternative because an effective implementation of a mutually recognised regime requires adequate progress in the strengthening and harmonization of key laws and practices in order to increase, investor protection, market integrity and systematic stability. The objective of regional capital market integration, regardless of the approach taken, should be to help build the efficiency, capacity, and liquidity needed to compete effectively amidst global markets and players. Thus, implementing regional integration should not exclude non-regional participants, but should focus on enhancing the capacity to compete both regionally and globally.

The ASEAN Economic Community (AEC) in 2015 is also a commitment of the ASEAN member states to make their nations borderless. The free flow of investments, goods, services, capital, and skilled labour should no longer become an obstacle among the ASEAN countries. People shall have no restrictions to make transactions among the ASEAN counterparts. The single market as the vision of the AEC 2015, is one of the big issues in the ASEAN region. This acceleration goes along with financial integration that consists of harmonized regulatory framework and a payment and settlement system. Furthermore, the financial integration of the payment systems is one of the tools the ASEAN members needs to implement in the single market.

There are crucial differences amongst the ASEAN member states from an economic point of view especially in terms of the flow of investments, goods and services. Furthermore, the member states are not familiar with each other laws, regulations and policies. This creates the possibility of conflicts. With regard to payment system, it involves and uses political, legal, economic, business practices and arrangements within the global market economy businesses in order to determine and exchange values or ownership of goods and services. Properly functioning payment systems enhance the stability of the entire financial system, reduce the transaction costs in the economy, promote the efficient use of financial resources, improve the financial market liquidity, and facilitate the conduct of monetary policy.

The ASEAN member countries have to progress towards realizing the ASEAN Economic Community (AEC) in 2015. In order to monitor the timely implementation of the AEC Blueprint, an AEC Scorecard was developed which serves as a tool to keep track of member states’ progress in implementing the commitments they have made. The Scorecard

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420 Ibid.
421 Ibid.
has two major goals: 1) to provide qualitative and quantitative indications of the ratifications, adoption and transposition into the domestic laws, regulations and administrative procedures of the agreed obligations and commitments within the prescribed timeframes as specified in the AEC Blueprint; and 2) to track implementation of agreements and achievements of the goals in the AEC Strategic Schedule.\textsuperscript{424}

2.2 The Significant Objectives and Characteristics of the AEC\textsuperscript{425}

2.2.1 The Objectives of AEC

The objective of AEC is to transform ASEAN into a region with free movement of goods, services, investment, skilled labour and freer flow of capital.\textsuperscript{426} Fostering economic development throughout ASEAN is also an important objective of the AEC, especially to enable the new ASEAN members to accelerate the pace of economic growth by designing the AIA, in order to enable them to participate on a similar level with the first six members.\textsuperscript{427}

2.2.2 The Characteristics of The AEC

Through the AEC 2015, ASEAN will become known as a single market with a vision to get more competitive with new processes to strengthen the existing economic condition, and to facilitate movement of businesses. It also strengthen the ASEAN’s mechanism itself. Hence, the AEC integrates many policies for anticipating and eliminating the obstacles such as the non-tariff barriers, then builds the commitments to strengthening the measures for trade facilitation, and creates harmonization laws and regulations to broaden and deepen the economic integration.\textsuperscript{428} In the beginning, to realize the AEC, ASEAN has been implementing the recommendations of the High Level Task Force (HLTF) on the ASEAN Economic Integration contained in the Bali Concord II.\textsuperscript{429} The author summarizes the characteristics of the AEC, as follows:\textsuperscript{430}

- A Single Market and Production Base

\textsuperscript{424}Ibid.
\textsuperscript{425}The description of the objectives and characteristics of the AEC in this section is merely to give information of the framework of the AEC, and not intend to discuss further detail on these matters, except matters that related to the payment systems.
\textsuperscript{427}Ibid.
\textsuperscript{430}Ibid, p.7, the author summarizes the AEC’s characteristics with additional opinion and explanation.
The ASEAN Single Market and Production Base has five components. These are free flow of goods, free flow of services, free flow of investment, freer flow of capital and free flow of skilled labour. The free flow of goods in ASEAN has achieved a substantial progress in the removal of tariffs, and the deletion of non-tariff barriers. In addition, another major elements that would facilitate free flow of goods are trade facilitation measures such as integrating customs procedures by creating the ASEAN Single Window (ASW), continuously enhancing the Common Effective Preferential Tariffs (CEPT), Rules of Origin including its Operational Certification Procedures, and harmonizing standards and procedures.  

Moreover, with regard to the free flow of services, there will be substantially no restriction to ASEAN services suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations. The actions should be taken, as follows:

1. Remove substantially all restrictions on trade in services for 4 priority services sectors, air transport, e-ASEAN, healthcare and tourism, by 2010 and the fifth priority services sector, logistics services, by 2013;
2. Remove substantially all restrictions on trade in services for all other services sectors by 2015;
3. Undertake liberalization through consecutive rounds of every two years until 2015;
4. Target to schedule minimum numbers of new sub-sectors for each round: 7 sub-sectors in 2015;
5. Schedule packages of commitments for every round.

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431 See further comment by Edmund W Sim, “Introduction to the ASEAN Economic Community”, April 11, 2008, at http://www.internationallawoffice.com/newsletters/Detail.aspx?g=8b8a24ce-5f76-4c90-bb9f-83a2a75e291, last accessed on January 20, 2015. He also stated that “unlike the European Union, The ASEAN Free Trade Area (AFTA) does not apply a common external tariff on Imported goods. For Goods originating within ASEAN, members must apply a tariff rate of between 0% and 5%, although the most recent members such as Cambodia, Lao PDR, Myanmar and Vietnam, have been given additional time to implement the reduced tariff rates. This is known as the Common Effective Preferential Tariffs (CEPT) Scheme. Members have agreed to enact zero tariff rates on virtually all imports by 2010 for the original signatories and 2015 for the four recent members. Furthermore, The CEPT applies only to goods originating within ASEAN. The general rule is that local ASEAN content must constitute at least 40% of the free on board value of goods. The local ASEAN content can be cumulative, that is the value of material, labour and processing inputs from various ASEAN members can be combined to meet the 40% requirements.”
433 Ibid, pp.15.
434 Based on GATS W/120 Universe of Classification.
435 This action has also been dealt with the financial sector parameter that all measures for the financial services sector will be subject to prudential measures and balance of payment safeguards as provided for under the WTO
Ahead, a free flow investment is a free and open investment regime to increase ASEAN’s competitiveness in promoting and ensuring the Foreign Direct Investment (FDI). This free flow of investment should protect all investors and should be covered by the comprehensive agreement, binding regulations, strengthen investor dispute settlement mechanism, and policies, so that these will provide legal certainty, will integrate the investment sector and at the end, will attract foreign investors.

In terms of the progressing of liberalization, various committees are working towards the vision of the ASEAN financial integration by addressing issues such as financial service liberalization, capital-account liberalization and payment systems integration. The purpose of this is to set free the flow of goods, services, labour and investment within the ASEAN region in the light of AEC 2015, while expecting in the same time to lower investment obstacles. While a single ASEAN currency is not included yet in the frame, one of the AEC 2015 financial policies is to encourage the local currencies among the ASEAN countries. Presently, cross-border trade is mostly paid in US dollars but the businesses often complain about the rate spreads and the transaction fees.

In the areas of offering rules for debt securities, disclosure requirements and distribution, the ASEAN Economic Community Blueprint stated that:

"the freer flow of capital as the fourth characteristics are to achieve greater harmonization in capital market standards in ASEAN rules; to facilitate mutual recognition arrangement or agreement for the cross recognition of qualification and education and experience of market professionals; to achieve greater flexibility in language and governing law requirements for securities issuance; to enhance withholding tax structure and promote the

General Agreement on Trade in services. These liberalisation measures of the financial services sector should allow members to ensure orderly financial sector development and maintenance of financial and socio-economic stability.


Ibid. The ASEAN+3 Research Study is still researching the question if this will be different if local currency is used. See further, the ASEAN Secretariat, “Ways to Promote Trade Settlement Denominated in Local Currencies in East Asia: Case Studies of Thailand, Singapore, EU and NAFTA”, ASEAN+3 Study Research Group, 2010.

broadening of investor base in ASEAN debt issuance; and to facilitate market driven efforts to establish exchange and debt market linkage including cross-border capital raising activities. Thus the fifth character, free flow of skilled labour in order to facilitate for the movement of natural persons engaged in trade in goods, services and investments according to the prevailing regulations of the receiving countries.”

- **Competitive Economic Region**

  With respect to creating a Competitive Economic Region, six core elements are included, namely: Competition Policy, Consumer Protection, Intellectual Property Rights, Infrastructure Development, Taxation, and E-Commerce. Furthermore, the key issues of achieving a competitive economic region are:

  "(a) **The development of regional guidelines on competition policy;**

  (b) **The need to conduct a comprehensive review of existing ASEAN Actions Plans (e.g., Intellectual Property Rights, Transport, Energy, among others) and to streamline them according to the Strategic Schedule of the AEC Blueprint; and**

  (c) **The creation of a Regional Infrastructure Development Fund with the participation of other ASEAN plus Three (APT) or East Asia Summit (EAS) partners.”**

- **Equitable Economic Development**

  Two core elements are included in the Equitable Economic Development objective, namely Small Medium Enterprises (SMEs) Development and Initiative for the ASEAN Integration. With regards to the objective of achieving equitable economic development, key issues include:

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440 SMEs stands for Small and Medium Enterprises, a business that maintains revenues or a number of employees below a certain standard. Every country has its own definition of what is considered a small and medium-sized enterprise. SMEs play an important role in ASEAN economic integration because between 95-99 percent of the firms in ASEAN Member States (AMS) are SMEs and contribute 23-58% to the GDP and 10-30% in total export. see further: “ASEAN SME Policy Index 2014:Towards Competitive and Innovative Asean SMEs”, Eria Research Project Report, No. 8, 2012. (Ed), by Eria SME Research Working Group, March 2014.

“(a) The need to undertake a full review of the ASEAN Policy Blueprint for SME development to identify real promising actions;
(b) Serious efforts to translate the concept of “ASEAN (regional) public goods” into practice;
(c) Development of mechanisms to deliver real and sustained technical assistance to the CLMV countries; and,
(d) Establishment of an ASEAN Development Fund (ADF).”

With regard to the objective of full integration into the global economy, the main challenges are:442

“(a) Development of approaches and mechanisms to strengthen ASEAN’s role as a “hub” in the East Asian integration; and
(b) Development of an effective and open regionalism cooperation schemes with other parts of the world (e.g., North America, Europe and Latin America).”

The assessment also emphasized on the following challenges and issues that ASEAN needs to address in achieving the AEC:443

“(a) Deal with the barriers to trade;
(b) Expediting investment and services trade liberalization;
(c) Strengthening the ASEAN Dispute Settlement Mechanism (DSM);
(d) Deal with the proliferation of FTAs; and
(e) Narrow down the development gap among ASEAN Member Countries.”

- Region Fully Integrated into the Global Economy

Finally, in creating a Region Fully Integrated into the Global Economy, ASEAN is aware that it needs to take into account external rules and regulations. In this regard, the two elements included in reaching these objectives are developing a coherent approach towards external economic relations and enhancing participation in global supply networks.

ASEAN never saw its future in building a fortress like a regional block. One of the unique features of ASEAN as a regional integrated entity is that trade as well as financial and business links with the rest of the world have not been weakened, while the intra-regional linkages have

442Ibid, pp.53.
443Ibid.
In fact, the AEC not only involves the economic integration of the ASEAN countries but also covers the harmonization of the economic policies among the ASEAN countries. The AEC being one component of the three pillars of the ASEAN community, will one day help achieve the grand vision of an integrated and united ASEAN community, like the European Union. The recognition of the importance of the partnership with other economies resulted in the inclusion of measures and actions related to deepening the integration of ASEAN into the global economy as part of the blueprint. To remain well integrated into and relevant for the rest of the world, it is not sufficient to rely on market forces, which have so far treated the ASEAN region as a favourable location for investment and production. Thus, the effort for deeper integration must include comprehensive and coherent technical assistance frameworks to assist weaker countries within ASEAN and enable them to become more effective part of regional and global production network.

2.3 The Challenges and Implications of the AEC

As mentioned above, the goal of the AEC as a single market is to achieve freedom of internal trade and free mobility of capital and labour as well as harmonization (of laws and regulations). But in fact, at that time the ASEAN governments are not prepared to create a customs union where trade barriers among member states have to be removed. There was recently a feasibility study from ISEAS regarding the possibility of creating an ASEAN Customs Union. This study supports the implementation of the single market by declining into zero common external tariffs or using a partial custom union. This study would be an option of ASEAN to create a custom union within the member states.

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447 Mia Mikic, *Op cit.*
449 The study has two options for ASEAN in moving towards a CU: either all its members will need to decline to a zero Common External Tariff (CET) like Singapore, or they will have to form a CU with a positive CET minus Singapore. This study also has several scenarios and internal challenges to implement it. See further: Sanchita Basu Das, *et al.*, “AEC Vision Post-2015: Is an ASEAN Customs Union Feasible?”, ISEAS Economics Working Paper No.2015-1, February 2015, at http://www.iseas.edu.sg/ISEAS/upload/files/ EWP20151.pdf, last accessed March 22, 2015.
The author summarizes the importance of how integration is carried out based on Petri’s observation, as follows:450

1. The single market that ASEAN builds has to be the “right” market. That means that the single market should reflect the characteristics and regulatory standards of the ASEAN member states. It will not always be possible to harmonize all standards within the region’s most advanced markets. This standard should be shifted into a regional level so that it is closer to those within ASEAN itself;

2. The production systems that ASEAN develops will need to be closely linked to their foreign counterparts. In this case, ASEAN should improve its scheme of policies and regulations, especially the environment of doing business and investing capital in order to get more attraction from its foreign counterparts.

3. ASEAN will need to market its market. This means that ASEAN should have an ASEAN brand, which represents a wide range of characteristics pertaining to those markets. Again, it needs real schemes to adopt standards and to have certifications. A strong ASEAN brand will not possibly be promoted adequately by individual members, but it should be done together.

The challenges which ASEAN face in achieving the AEC, as Pushpanathan Sundram mentioned, are as follows:451

“The key challenge for ASEAN is to stay the course in community building as a whole. While readiness is important, it is not sufficient to deliver the AEC by 2015. The building of the AEC will need strong leadership, vision, political


451Pushpanathan Sundram, Opelit, last accessed on October 25, 2011. See further, The several challenges facing ASEAN in achieving AEC 2015. Firstly, ASEAN has to manage the integration process and achieve the targets within the timeframes that have already been agreed. Secondly, the ASEAN countries should actively address the non-implementation of regional commitments, which should include capacity building to tackle any inadequacies in implementing commitments; peer reviews for sharing and learning of best practices as well as transparency and confidence-building; and utilizing the dispute settlement mechanisms already in place to resolve issues in a rules-based manner. There could also be specific target-setting to encourage ASEAN to achieve more. For example, there could be specific targets for bringing down the costs of doing business in ASEAN. Thirdly, a robust regional surveillance mechanism is necessary to track emerging risks in the AEC and to deal with them in a timely manner. In this regard, the ASEAN Secretariat will soon be establishing a Macroeconomic and Finance Surveillance Office which will undertake surveillance on economic and financial integration issues. Fourthly, financing the development of an ASEAN single market and production base will continue to be a challenge. In this regard, ASEAN countries should look at innovative and creative ways to augment the funds being provided by dialogue partners and donors to support ASEAN economic integration. Fifthly, the development within ASEAN certainly deserves more attention to realize the AEC by 2015. Sixthly, the private sector of ASEAN must be better engaged in building the AEC as they are the principal driver of regional economic integration. There should be regular sector-specific dialogue with the business community so that ASEAN can address their concerns and create a more facilitating environment for doing business in the region.
will as well as strong mechanisms and institutions to support coordination and implementation, both at the national and regional levels. ASEAN must continue to stay open and engage its partners to maximize the gains from the AEC given our outward-looking economic orientation. A transformation of mind-set from “national interest to regional action” to “regional interest to national action” is also necessary for community-building as a whole.”

Since the date set for the AEC is approaching, so it needs to be recognised that the growth process of regional integration has to speed up. Thus, in this area, there is a need to focus on strength and to build cross trading of financial instruments in various markets and facilitate intraregional payments and settlement.452

An integrated payment system cannot be created from scratch, but it has to be pushed by economic needs and/or be pulled by political will.453 The performance of the ASEAN regional economic cooperation is fundamentally based on two conditions, namely government and markets,454 and this time the condition of the ASEAN member states have a deeply rooted concept of sovereignty, so that it is highly unlikely to strengthen cooperation through large scale sovereignty transfer. Further regional economic cooperation is difficult because of limited market scale of internal regional market, competition among member countries as well as dependence on the external market.455 In order to have a good performance within the region members, these must be transformed considerably.

The author argues that the implication of the AEC is a need for acceleration of financial regional integration to develop a single market in ASEAN. They need a connection among the member states through technology in order to have an efficient and effective free movement of products and services. The author argues that an integrated payment system is one of the effective and efficient service instruments that may support the acceleration of financial regional integration. Furthermore, to achieve a financial integration, strong commitments are needed from leaders who have a great vision and strong political will, as well as well-built mechanisms and institutions to back up the achievement of the AEC.

452This target expected is in line with the function of an Independent Asian Financial Institute (AFI), as proposed by Eichengreen, in Ramkishen S. Rajan, “ASIAN Economic Cooperation and Integration : Sequencing of Financial, Trade and Monetary Regionalism”, July 2004 at http://ramkishenrajan.gmu.edu/pdfs/publications/Published_Academic_Papers/2005/sianregmem.pdf, last accessed on January 22, 2015. The tasks of AFI would assigned the following tasks: strengthening prudential supervision and regulation, running training and capacity building programs for bank supervisors, securities and exchange commissioners and accountants, helping design region wide financial standards and regulations and provision of liquidity to countries that find it hard to adjust to the standards, and facilitating regional clearing and payments settlements among central banks in the region.
455Ibid
2.4 The Benefits and Contributions of the AEC

The positive effect of building a strong and highly competitive common market will allow the ASEAN economies to gain more benefits from the world markets. It will at the same time provide a better bargaining position for the individual member states with regard to the trade in the product exported in international market. It will also be a good step for the ASEAN members to assure open access to whole markets around the world which will raise the ASEAN members’ capacity to attain good market access.

The ASEAN Economic Integration brings the following benefits to the economic development of the region:

“First, it creates a peaceful, cooperative and coordinative macro environment, which is absolutely necessary for economic development. ASEAN countries are beware of its importance increasingly. Second, it reinforces external development strategies of member countries and has impact on internal economic development model. Regional economy has become an integral part in external development strategies of member countries.”

Peter Robson describes that:

“Experience of many countries in the world (including tiny countries) proves that although membership in an economic community is not a necessary premise for economic success, it does not exclude the possibility that those who have been successful without participation in integration are likely to be more successful if they become a member of a suitable community.”

With regard to the second benefit in above mentioned, Hettne, Inotai and Sunkel point out:

“Development regionalism refers to concerted efforts from a group of countries within a geographical region to increase the complementarity and capacity of the total regional economy as well as finding the right balance between function and territory.”

Based on the development regionalism conditions, Hettne, et al. argue that, from the point of view on indirect and broader economic returns, regionalization (for example, in

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456 See http://agreement.asean.org/media/download/20141003172848.pdf, last accessed on January 22, 2015
“cooperation” process) among the ASEAN countries has important and positive impact on the economic development.\footnote{Ibid.}

Additionally, Guangsheng emphasizes the following:\footnote{LU Guangsheng, \textit{Op cit.}, pp.64.}

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in the view of development regionalism, the benefits of regionalization in Southeast Asia are: to bring political stability and developmental authoritarianism of Southeast Asia and make it locked in and consolidated in the system; to cut down military expenditure; to strengthen dynamic economic links through several ways, like regionalized network production, trade, investment and allocation, three growth engines and policy coordination in accepting foreign capital; to enhance collective bargain capability in foreign affairs; to improve status in global politics and economy; to build resource management mechanism (for example, establishment of dispute settlement mechanism of resource management).’’
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The AEC itself is concerned with regional financial integration, which focused on the process of financial liberalization. Williamson and Mahar identified six dimensions of financial liberalization that can be summarized as:\footnote{John Wiliamson and Molly Mahar, “A Survey of Financial Liberalization”, \textit{Princeton Essays in International Finance} No. 221, 1998, pp.1.}

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(i) Elimination of credit controls;
(ii) Deregulation of interest rates;
(iii) Free entry into financial services industry;
(iv) Bank autonomy
(v) Private ownership of banks;
(vi) Liberalization of internal capital flows.’’
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With regard to financial integration, ASEAN has implemented ASEAN Single Window (ASW), as one of good examples, to ensure a rapid and accurate payment to governmental authorities and agencies for required duties and any other charges.\footnote{Prof. Dr. Rolf H. Weber, “Legal Framework for the Single Window Concept in ASEAN – A successful Movement Towards Trade Facilitation in East Asian Countries”, \textit{Asian Journal of Law and Economics}, Volume 2, Issue 4, Article 2,2011, pp.4. The ASW is the environment where National Single Window of member states operate and integrate. The NSW is a system which enables a single submission of data and information which is used by customs in making a decision to release and clearance of cargo. See Protocol to Establish and Implement the ASEAN Single Window.} The implementation of a single window can be highly beneficial for both governments and trading communities. For Governments it can bring better risk management, improved levels of security and increased revenue yields with enhanced trader compliance. For trading communities will benefit from transparent and predictable interpretation and application of rules, and better deployment of human and financial resources, resulting in appreciable gains in productivity and competitiveness. In addition, a single window can simplify and facilitate
the process of providing and sharing the necessary information to fulfil trade-related regulatory requirements for both traders and authorities to a considerable extent. Furthermore, the use of such a system might result in improved efficiency and effectiveness of official controls and in reduction of costs for both traders and governments due to better use of resources.\textsuperscript{464} The benefits of the single window concept encompass the implementation of a better risk management, the improvement of security levels and increased revenue yields with enhanced trader compliance, the transparent and predictable interpretation and application of rules, the better deployment of human and financial resources as well as the achievement of gains in productivity and competitiveness.\textsuperscript{465}

In the future, the AEC will reduce the development gaps among its member states and raise regional economic prosperity and stability. Apparently, once economically integrated, the AEC could improve efficiency, enhance effectiveness, and also may strengthen the economic fundamentals within the region.\textsuperscript{466} However, it needs a strong efforts from the member countries to integrate their economic in the same speed, due to the difference of economy level among the member states. The governments should synchronize and implement coherence and commit policies which are written in the AEC Blueprint.\textsuperscript{467} The formation of an AEC will also benefit to play a more effective part in determining a financial system that more responsive to its needs.\textsuperscript{468}

It is clear that at the ASEAN level, the diversities in the levels of economic development and capabilities are quite wide, thus, it offers more extensive and mutually beneficial linkage. The diversity in economic structure gives its own indigenous capacity and markets for dynamic industrial restructuring within the region on the basis of ‘flying geese’ patterns.\textsuperscript{469} The Asian region encompasses some of the fastest growing economies in the world, forming an enormous market that is growing faster than any other region in the world.\textsuperscript{470} The development of an AEC will assist the member states in the region to

\textsuperscript{464}Ibid. See also, Recommendation and Guidelines on establishing a Single Window, UN/CEFACT, at http://www.unece.org/fileadmin/DAM/cefact/recommendations/rec33/rec33_trd352 e.pdf, last accessed on January 22, 2015. Through an ASW, traders electronically submit forms for export, import, and transit procedures only once, and they are processed and cleared by multiple government agencies in a single integrated process. The ASW will provide a secure architecture that allows NSWs to exchange cargo clearance data electronically.


\textsuperscript{467}Ibid.


\textsuperscript{469}Ibid.

\textsuperscript{470}Ibid.
participate and play a more effective role in determining a world trading and financial system that is more responsive and reactive to its needs.

According to Petri, et al., the AEC would yield benefits similar to those of the European Union regarding the financial integration. This is remarkable since the ASEAN economies are less closely integrated and are arguably less complementary than those of the European Union (EU) were at the outset of the EU initiative. However, given the relatively early stage of development of some ASEAN members, existing barriers to trade are greater and their elimination could yield larger productivity gains in relation to current trade. Although difficult to comprehend for the author, according to Petri, these benefits show to compensate the result of less integration. As ASEAN economies continue to mature and work more closely together, the benefits of the AEC should grow, and with rising incomes and trade, ASEAN is also likely to develop the horizontal, inter-industry linkages that have come to characterize the later stages of the European single market effort.

2.5 The Implementation of the AEC from Legal and Political Overview

In order to achieve the goals of the AEC, Rolf Weber states that there are factors and elements to be taken into consideration. These factors and elements are as follows:

- **Political will**: Both government and business should be interested to implement a project. They should make the necessary resources available and agree on the proper dissemination of clear and impartial information. It is obvious that the role and the involvement of the government and related industries are needed in this matter.

- **Partnership between government and trade**: The successful implementation of a project makes it necessary that all relevant public and private agencies and organizations participate in the development of the system and are involved in its processes. It requires a harmonized cooperation between government and industries.

- **Definition of clear project objectives**: The implementation of a project must be based on a careful analysis of the needs, aspirations and resources of the key stakeholders, in particular in respect of the given infrastructure. The parties should have a clear objective in order to implement the single window.

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472 Ibid.
473 Ibid.
474 Such elements and factors are based on the experience of implementing a single window. These factors and elements are also considered to be a good example for establishing an integrated payment system in ASEAN.
- **User friendliness and accessibility**: A project should encompass the requirements of adequate operating guidelines, support services. The standard and procedure must be clearly known and understandable by parties involved.

- **Strong lead agency**: The implementation of a project is more likely if a strong, resourceful and empowered lead organization is driving the project.

- **Financial model, promotion and communication**: Clear guidelines as to the financing of a single model are needed. In addition, establishing a proper mechanism for keeping all stakeholders informed on project goals, objectives, targets, progress and difficulties of a concept creates trust and avoids misunderstandings. The standard and procedure should be clear and transparent to parties involved.

- **Payment possibility**: The inclusion of possible payment mechanisms makes a project more attractive. There should be options of payment mechanisms that could be more attractive for industries.

- **Legally enabling environment**: As mentioned, legal issues and restrictions are to be identified and carefully analysed; a clear and predictable legal environment leads to trust of the involved stakeholders. This point refers to providing a legal certainty for parties involved.

Overall, the success of the future development efforts in ASEAN will greatly depend on the political will to implement development plans, that the main thrust of the strategy for the region's development in the future must be integrative in nature or at least, policy-wise, multidimensional. Furthermore, the role of the government in the future requires an effective overall administrative framework to undertake co-ordination and supervision over the various interrelated development projects.\(^\text{476}\)

Moreover, John H. Jackson mentioned: \(^\text{477}\)

> "....international trade relations in the world today... is a very complex mix of economic and governmental policies, political constraints, and above all an intricate set of constraints imposed by a variety of rules or legal norm."

The above statement of John H. Jackson indicates that it is applicable to the whole international economic activities, which involves legal aspect as well as politic factor. Related to the legal issues of the single window concept, Rolf Weber and Schermer explained some issues, which need to be addressed that should be taken into consideration. \(^\text{478}\)

\(^{476}\)John Wong, *Op cit.*


From the description above, the author comes to the conclusion that some requirements should be taken into consideration in order to create and implement a new policy, project, program, or initiative, like the single window, as follows:

- There is a necessity of political will, both from the government and related business industries. Moreover, other elements such as legislative and judicial bodies should support this project, especially related to the legal aspects.
- There are needs for legal basis and well-structured organization in implementing the program/initiative. The legal basis itself comprises of rules and procedures related to the program to provide a legal certainty and safeguard the parties involved in such program.
- There are also needs for a well-managed dissemination and education to public in order to provide awareness and readiness of the society regarding to the program.

2.6 The AEC’s Dispute Settlement

The development of the AEC is in its early stages and many of the key foundations of an integrated market, such as predictability, transparency and the right to seek dispute resolution, are not as well-grounded as in national states or other regional economic blocs, such as the European Union. The AEC dispute settlement mechanism for economic agreements also demonstrates an effort to construct economic integration the ASEAN Way. Regarding dispute resolution mechanism, the member states avoided a processed dispute resolution mechanism for over a decade. Demonstrating their gradual acceptance of rules based economic integration, the members crafted a Dispute Settlement Mechanism in 2004, but it nevertheless remains an option rather than a mandate and permits a member state at any time to engage in conciliation or mediation. Moreover, the whole procedure is managed by a group of political representatives from each member state, which would make decisions by consensus, and as a fact, no dispute has yet been processed through the dispute settlement mechanism (DSM), and member states simply resolve some agreements when they are unable or unwilling to implement earlier ones. This ASEAN way of thinking in building consensus

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479 Edmund W Sim, “Introduction ASEAN Structure ASEAN Free Trade Area Other Aspects of the AEC Free Trade Agreements Outlook”, Opcit.
481 See also : The CEPT Scheme’s original dispute settlement mechanism differed little from the ASEAN way, providing only that member state afford each other opportunities for consultation at Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area Art.8(1), 28 January 1992.
and non-interference policy process is ineffective because it has no strong legal and decision making framework.\textsuperscript{484}

According to R. Aldaba and Yap, ASEAN has three interrelated dispute resolution mechanisms that address the implementation of obligations under the ASEAN agreements: the ASEAN Consultation to Solve Trade and Investment Issues (ACT), the ASEAN Compliance Body (ACB), and the Enhanced Dispute Settlement Mechanism (DSM).\textsuperscript{485} The ACB is advisory in nature while the DSM is binding.\textsuperscript{486} Moreover, ASEAN has developed three key mechanisms for dispute settlement: the 1976 Treaty of Amity and Cooperation (TAC); the 1996 Protocol on Dispute Settlement Mechanism and subsequently the 2004 Protocol for Enhanced Dispute Settlement Mechanism (EDSM) for disputes relating to ASEAN economic agreements; and the provisions of the 2007 ASEAN Charter that serve as an overarching framework for dispute settlement in ASEAN. Unfortunately, to date, neither the High Council of the TAC nor the EDSM have been utilized by member states.\textsuperscript{487} The Protocol on the Dispute Settlement Mechanism (the ASEAN DSM), that to a substantial extent is similar to the dispute settlement mechanism in the GATT era and the ASEAN EDSM resembles the WTO DSM.\textsuperscript{488}

The ASEAN Economic Ministers’ High Level Task Force (HLTF) on Economic Integration had unveiled a slew of economic initiatives with clear deadlines to expedite the economic integration process to realize the AEC.\textsuperscript{489} One of the most important recommendations by the HLTF was the creation of a more effective Dispute Settlement Mechanism (DSM) with powers to make legally binding decisions in resolving trade disputes among member states.\textsuperscript{490} This process is as end-goal for AEC in moving towards improving the existing ASEAN DSM, in order to ensure and provide legally binding resolution of any economic disputes. Since the number of trade disputes will likely rise significantly as the region moves towards a higher level of economic integration, a credible DSM would be


\textsuperscript{486} Ibid.


\textsuperscript{489} Denis Hew, “Economic Integration in East Asia : An ASEAN Perspective”, UNISCI Discussion Paper No.11, Institute of Southeast Asian studies (ISEAS), Singapore, 2006, pp. 50.

\textsuperscript{490} Ibid, pp. 51.
absolutely critical for the AEC to succeed, and there some measures should be undertaken to enhance the DSM. 491

“- Establish a legal unit within the ASEAN Secretariat to provide legal advice on trade disputes;
- Establish the ASEAN Consultation to Solve Trade and Investment Issues in order to provide quick resolution to operations problems (this would be similar to the EU mechanism);
- Establish the ASEAN Compliance Body.”

In 2010, the Protocol to the ASEAN Charter on Dispute Settlement Mechanisms (ACDSM) was signed by the Foreign Ministers of ASEAN in Ha Noi, Vietnam. This current protocol provides more extensive rules and processes for dispute settlements. The ACDSM will apply not only to the interpretation and application of the ASEAN Charter, but also to other ASEAN instruments. Moreover, the ACDSM creates a dispute settlement mechanism which allows the ASEAN Summit to approve a decision if consensus among the ASEAN members cannot be reached. The author observes that this current Protocol (ACDSM) provides arbitration mechanism as tools for resolving the disputes. 492 This is a better step for ASEAN of having a better Dispute Settlement Mechanism which is expected to be used by the member states for the solutions of their disputes.

2.7 ASEAN Economic Community (AEC) Integration: Seeking Values and Empowering the Organ(s)

During the financial crisis in 1997, ASEAN countries became disunited in terms of its economic policy. Consequently, they became more focused on their internal interests. After the crisis, individual ASEAN members sought to secure its own economic interests outside the ASEAN framework. For example, Singapore was frustrated by the slow leap of integration after the crisis and responded by signing bilateral trade deals with the EU, Australia, Canada, Chile, Japan, Mexico, New Zealand, South Korea, India, and the United States. 493 The Philippines followed in 2002 by signing a bilateral FTA with Japan. 494 Then

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492 See Article 8 of ACDSM.


Malaysia followed the two previous members by subsequently expressing its interest in negotiating a FTA with Japan.\footnote{Takashi Terada, “The Making of Asia’s First Bilateral FTA: Origins and Regional Implications of the Japan-Singapore Economic Partnership Agreement”, \textit{Pacific Economic Papers} No. 354, 2006, \textit{Australia-Japan Research Centre}, can be seen at \url{http://www.crawford.anu.edu.au/pdf/pep/pep-354.pdf}, last accessed on January 22, 2015.}

This phenomenon happened due to the lack of institutional mechanism and the inability of ASEAN to provide a better arrangement for the members to recover and develop their economies. Furthermore, since the crisis ruined the members, it demonstrated that the principle of non-interference in domestic affairs was a major obstruction that impeded the capability of ASEAN to rise again from the turmoil. Nevertheless, it must be admitted that the norms of consensus and consultation (the ASEAN Way) have been effective in averting political and security conflicts within the ASEAN member states, especially the worries of the domino effect of Vietnam War and Cambodia and Myanmar’s conflicts. The political approach is more efficient in these matters at that time. Kraft points out that these norms also were acknowledged to be key factors in the economic development of a number of the ASEAN member states and, more importantly, in preventing the outbreak of wars between them.\footnote{Herman J. S. Kraft, “Driving East Asian Regionalism: The Reconstruction of ASEAN’s Identity”, in Ralf Emmers (ed.), “ASEAN and the Institutionalization of East Asia”, \textit{Routledge}, 2012, pp.63.}

Nowadays, since the Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV) became members of ASEAN, those risks have declined, but ASEAN still needs an approach, which can manage security and business shifting from conventional norms to forward-looking norms. The ASEAN Charter is one of the examples of the forward-looking capacity from the ASEAN Leaders and it is a stepping-stone for transition. It includes an ASEAN Protocol on Enhanced Dispute Settlement Mechanism, which rules dispute resolution for AFTA and other arrangements of ASEAN. But then again, in practice, when the disputes arise, the disputes are resolved bilaterally through informal means. The mechanism dispute settlement which is stated in the Charter is never implemented. This can also be annoying for corporations implicated by an ASEAN arrangement, such as the AFTA dispute, and they often try to find a dispute resolution in another forum such as the WTO or the International Court of Justice (ICJ).\footnote{The seeking of the other fora outside the ASEAN dispute mechanisms happened in the ASEAN members, which were ruled by ICJ i.e. case between Indonesia vs. Malaysia (Pulau Sipadan and Ligitan) and Singapore vs. Malaysia (Middle Rocks and Pedra Branca).} Such developments which are far from the spirit of the ASEAN integration. However, Kraft is questioning the binding norms. He states that whatever the norms adopted by ASEAN, they must have binding authority – meaning that the Association must be able to enforce sanctions against non-compliance.\footnote{Herman J. S. Kraft, \textit{Op. cit.}, pp.70.} Additionally, he also argues that norm building must be supported by proper institutions that will allow and facilitate the enforcement of these norms.
norms. There is a need to increase the level of institutionalization of ASEAN even when there is an implied reticence to do so.\textsuperscript{499}

Hadi Soesastro also pointed out that there is no point in pursuing an advanced and demanding notion as an AEC without deeper and testable commitment of the member states and stronger institutions or a detailed treaty from the outset.\textsuperscript{500} He also stated that regional energies must also be invested in institutional development to effectively implement initiatives, actions, and programs to realizing the AEC. Additionally, there is a need for ASEAN to develop a new ASEAN way in achieving the goal of an AEC, which is part of the broader ideal of an ASEAN Community.\textsuperscript{501} Without endowed ASEAN institutions, without a treaty, without transfer of powers, and without any budget, one should not expect a credible ASEAN Economic Community to emerge.\textsuperscript{502} Moreover, Stubbs observes that economic transactions are seen as part of the general social interactions rather than governed by the rule of law.\textsuperscript{503}

From the above descriptions, the author argues that it seems that ASEAN is still reluctant to shift from the informal manner to ruling of law, and to transfer power from the member states to association. Subsequently, in order to attain the AEC and to deepen the economic integration within the ASEAN member states, there are two important elements that should be considered. These two elements are: first, a legal certainty by developing binding arrangements, and second, the importance of deepening and empowering the regional institutions or bodies that could make regulations, decisions and supervisions for ASEAN. These two elements are a must-have for ASEAN in achieving the AEC. When we are talking about agreement related to financial concerns, unquestionably the parties need a binding arrangement to protect their interests. A number of other ASEAN agreements as well as the ASEAN agreements with the dialogue partners (e.g. the free trade agreements) also contain specific clauses on dispute settlement.\textsuperscript{504} ASEAN need some instruments that can assure them with a certainty, such as legal certainty and legal enforcement. Furthermore, the regional economy needs a legal certainty to smooth the single market in ASEAN. They need an efficient decision-making mechanism rather than a political decision-making process from the Leaders of the member states meeting, which is too long and contains a lot of political interests.

With regard to economic integration especially a financial market integration, it appears to the author that such integration needs a payment system instrument, which is

\textsuperscript{499}Ibid.  
\textsuperscript{501}Ibid.  
\textsuperscript{502}Ibid.  
\textsuperscript{504}Center for International Law, “Dispute Settlement in ASEAN”, \textit{Op cit.}
smooth, fast, efficient, safe and certain. Besides standardization of the payment systems, the legal harmonization is also necessary and important. To harmonize regulations, ASEAN should be given legal supremacy over national laws and it needs an institutional mechanism. Thus, for economic integration, the institutionalization, the supervision and the legal instruments, which are binding and enforceable to all the ASEAN member states, are needed. With regard to a legal certainty and effective decision-making mechanism, Pushpanathan stated in his keynote address at the FX Week Asia Conference 2009 in Singapore that the Chiang Mai Initiative Multilateralization (CMIM), which provides US$120 billion swap arrangements under the CMIM needs a legal agreement and an independent regional surveillance unit to support the decision-making process of the CMIM.\(^{505}\) Christopher Roberts also argues that by having the agreement of the CMIM, the ASEAN members were also willing to adopt a more flexible decision-making process in relation to their economic agreements.\(^{506}\) It seems to the author that ASEAN is no longer dealing only with cooperation but also with regional integration. Given the increasing demands of financial globalization, the ASEAN region must prepare the necessary policies and infrastructure to be in place in order to cope with the needs of financial integration.

One of the most important matters for ASEAN in order to implement the AEC objectives effectively is to design an institution/body and to create the regulations that are applicable and binding for all member states. This reasoning was also inspired by Roberts’ statement on the crisis effect that smashed the ASEAN’s economy. He argues that the devastating effects were also due to the lack of the institutional mechanisms and capacity, ASEAN necessary to provide tangible assistance for the purpose of either the recovery of its member economies or the prevention of political instability.\(^{507}\)

The ASEAN Charter has also provided the ASEAN Secretariat with some forms of functional capacity, but the influence of the Secretariat remained low. Dr. Munir Majid criticized the secretariat as "weak", saying that it is not given the authority to carry out its role effectively.\(^{508}\) He argues that it does not necessarily mean giving it more power or money, but giving it a stronger role.\(^{509}\)

The author agrees with Dr. Munir, but the Secretariat needs more than that. As an institution that has authority, it needs more power to regulate, to decide, and to control. It also


\(^{507}\) Ibid pp. 91.


\(^{509}\) Ibid.
needs credible and capable staff and adequate funds for achieving the AEC. These components were thought out by Surin Pitsuwan as a former Secretary General and chief administrative officer at the ASEAN Secretariat. He argued that the Secretary General and his office should be given sufficient trust and latitude to carry out their responsibilities. Furthermore, he said that they also need sufficient financial support, personnel and infrastructure, including modern technology. He compares the ASEAN annual budget of US$15.763 million to the EU which has a budget of well over €147.2 billion for 2012 alone.

Although such comparison, according to the author does not make sense, since the EU has different structural and responsibilities, he agrees that those components should be empowered, especially the delegated power to regulate, impose sanctions and doing supervision. They should also create bodies or committees with such power, especially to create a cross-border payment system. But it is acknowledged that this cannot be implemented in just “one night”. It will need a certain period of time.

2.8 ASEAN’s Dimension for the AEC: Intergovernmental vs. Supranational Institution – Learning from the EU Experience

When we discuss creating and promoting regional integration, this process is mostly influenced by how the member countries in the specific region create, develop and integrate. It has been established that ASEAN has intergovernmental characteristics and the EU has supranational attributes. In this sub chapter, the author will explain the impact of globalization and integration to a region’s characteristics and how to learn from the EU perspective, which will finally give an idea to ASEAN of how to seek the values necessary for its economic/financial integration especially for attaining the AEC.

It is acknowledged that the establishment of ASEAN was originally initiated for security reasons. Thus, the development of the ASEAN vision is greatly influenced by the leaders of the member states and they have played a central role in ASEAN since its establishment until the creation of the AEC. This intergovernmental character has led the association in dealing with the issues using a political instead of legal process.

In the global and integration era, which involves and deals with many countries, the regional powers need to be taken into consideration for ruling the national level. In providing more power to the regional level, the sovereign power of each nation, in certain manner and to

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511 Ibid.
512 Ibid.
513 See, for example, the ECB and TARGET which have three structural organs, the Governing Council, the Executive Board and the General Council.
a certain degree, should be shifted to the association. The region countries may establish an institution with supremacy power to manage their common interests (called supranational institution). By learning from the EU, supranational institutions may be established to facilitate domestic and regional interests which will benefit all member states. By having supranational institutions, every member has the same rights and obligations, because each member state delegates their power to the institution to manage and regulate them. However, Guy Peters keeps reminding that governments remain significant actors in the EU context.\footnote{B. Guy Peters, “Developments in Intergovernmental Relations: Towards Multi-Level Governance”, \textit{The Policy Press}, vo.29, no.2, 2001, pp.131-135.}

On the one hand, as Moravcsik\footnote{His research is on European Integration for Developing the Theory of Liberal Intergovernmentalism.} argues, the European Community (EC) is the most successful example of an institutionalized international policy co-ordination in the modern world, and yet there is little agreement about the proper explanation for its evolution.\footnote{Andrew Moravcsik, “Preferences and Power in the European Community: A Liberal Intergovernmental Approach”, \textit{Journal of Common Market Studies}, Basil Blackwell Ltd., Vol.31 No.4, December 1993, pp.473.} He explains that the EC has developed through a series of celebrated intergovernmental bargains since the signing of the Treaty of Rome in 1958 until the making of Maastricht Treaty in 1992, each of which set the agenda for an overriding period of consolidation.\footnote{Ibid.} Moreover, he also argues that the EC can be analysed as a successful intergovernmental regime designed to manage economic interdependence through negotiated policy co-ordination.\footnote{Ibid. pp.474.}

Another scholar, James Caporaso, states that the most important virtue of domestic politics is how a society constructs its institutions, and also the way these institutions are built is thought to affect political outcomes.\footnote{James A. Caporaso, “Toward a Normal Science of Regional Integration”, \textit{Journal of European Public Policy} 6(1), 1999, pp.162.} He also supports Moravcsik’s model with his statement below.\footnote{Ibid. pp.474.}

“Yet Moravcsik’s underlying model is one of societal pluralism, particularly economic pluralism. Economic factors, particularly the distribution of commercial and productive interests, work their way up toward the national leaders, who in turn carry these preferences into international negotiations. The results of the negotiations are then locked in by institutions.”

On the other hand, Alec Stone Sweet and Wayne Sandholtz have a shifting theory of the EC from an intergovernmental to a supranational, called the Continuum measures, as follows.\footnote{Alec Stone Sweet and Wayne Sandholtz, "European Integration and Supranational Governance", \textit{Faculty Scholarship Series, Paper 87}, 1997, pp.304. also can be seen at: http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1086&context=fss_papers, last accessed on January 22, 2015.}
“The continuum measures the movement from intergovernmental to supranational governance in three interrelated dimensions:

- EC rules: the legal, and less formal, constraints on behaviour produced by interactions among political actors operating at the European level;
- EC organizations: those governmental structures, operating at the European level, that produce, execute, and interpret EC rules; and
- Transnational society: those non-governmental actors who engage in intra-EC exchanges - social, economic, political - and thereby influence, directly or indirectly, policy-making processes and outcomes at the European level.”

They are also inspired by the founders of the integration theory, Karl Deutsch and Ernst Haas, who declared later the theory of neo-functionalism in 1950’s.\textsuperscript{522} In their journal, they also state Deutsch’s emphasis on social exchange, communication and transactions, and Haas’ attention to the relationship between global interdependence, political choice, and the development of supranational institutions.\textsuperscript{523} From these opinions, Sweet and Sandholtz agree that social exchange across borders drives integration processes, and generates social demands for supranational rules, it also pushes the integration process towards higher levels of organizational capacity which can respond to further demands. If this demand is not supplied, the development of higher levels of exchange will be stunted.\textsuperscript{524}

From the above description, the author is on the opinion that the path of the EU history to become one of the most respectable organizations in the world, initially started with an intergovernmental character, and then due to social exchanges between the member states, followed by communications and starting cross-border economic transactions, they became interdependent and needed integration by seeking political bargaining through negotiations between the leaders of member states to create a supranational institution as a final form of consolidation. It is like Anneli Albi’s opinion in her book, which mentions that the EU is rather a novel and unique combination of supranational and intergovernmental structures to which nation-states remain central, and where democratic legitimacy emanates from multiple levels.\textsuperscript{525}

With regard to the ASEAN dimension, the author also sees that the need for transformation from intergovernmental to supranational institution is essential for the deepening of the ASEAN’s economic integration. The key success for achieving the AEC objectives is the creation and/or empowering of the ASEAN institution(s) with the authority

\textsuperscript{522}Neo-functionalism describes and explains the process of regional integration with reference to how three causal factors interact with one another: (a) growing economic interdependence between nations, (b) organizational capacity to resolve disputes and build international legal regimes, and (c) supranational market rules that replace national regulatory regimes. See further at Ernst Haas “International Integration: The European and the Universal Process,” \textit{International Organization}, 15. 1961, pp.366-392.

\textsuperscript{523}Ibid., pp.300.

\textsuperscript{524}Ibid.

\textsuperscript{525}Anneli Albi, “EU Enlargement and the Constitutions of Central and Eastern Europe”, \textit{Cambridge University Press}, 2006, pp.203.
to make regulations, to make decisions, to carry out supervisions, and to impose sanctions. ASEAN does not have to leave the intergovernmental characteristics behind at once. There will be a gradual change and obviously a long-term development in nature. Although, the time line of ASEAN to face AEC is less than one year, the author is aware that ASEAN still needs more time to adjust that combination to its own unique and specific regional characteristics.

2.9 A Glimpse of MERCOSUR: Learning from its Economic Integration Experience

Besides learning from the EU, it might be wise and necessary for ASEAN to see and learn as well from the other region which has a similar motivation in integrating their economic region. One of such regions is Latin America with its MERCOSUR or the Mercado Comun del Sur, also known as the Common Market of the South. ASEAN, also sought political and economic relationships with this Latin America region.526

MERCOSUR was established under the Asunción Treaty in 1991.527 It was set up with the ambitious goal of creating a common market between the participating countries. At first, it started with four member countries: Argentina, Brazil, Paraguay and Uruguay while Venezuela joined six years later, and Bolivia became member of MERCOSUR in 2012. Four instruments are needed to be applied in order to achieve a common market: trade liberalization, the creating of common external tariffs, the coordination of macroeconomic policy and the commitment of harmonizing their legislation.

Since its establishment until 1997, MERCOSUR experienced a golden era, which attracted large amounts of Foreign Direct Investment (FDI) to the region. This was interrupted by the financial crisis in East Asia and Russia in late 1997.528 Argentina had a debt crisis in 1998, while Brazil was impacted by a devaluation of its exchange rate. In the beginning of 2003, the trade of MERCOSUR recovered and increased by negotiations with countries outside the region such as Egypt, Morocco, India, Israel, and the Southern African Customs (SACU).529

There are six organs of MERCOSUR i.e. the Common Market Council (CMC), the Common Market Group (CMG), the Trade Commission of MERCOSUR (CCM), the Parliament of MERCOSUR (PM), the Permanent Tribunal of Review (TPR), and the Secretariat of MERCOSUR.530 But only the first three organs have decision-making powers.531

528Latin America was impacted by the financial crisis in 1997 like the ASEAN region.
531See Protocol of Ouro Preto Art. 2.
The Common Market Council (CMC) is the highest body of this organization, responsible for the political decisions and is composed of the ministers of foreign affairs and the presidents. It adopts measures, which are binding to all state parties. The CMG and the CMM are the executive organs, consisting of officials from ministries of foreign affairs and economics and also the representative of the central banks. The latter supports the CMC regarding trade and commercial issues. The Secretariat of MERCOSUR is an assisting body, providing technical and administrative support to all MERCOSUR organs.

With regard to the power to regulate, the Parliament of MERCOSUR is a new organ replacing the Joint Parliamentary Commission (JPC). It is expected to balance the role of the presidential power. However, none of these functions was fully performed and it only had an advisory role and have no power to make laws. The Parliament of MERCOSUR has the role to work together with national parliaments with the aim of ensuring compliance with MERCOSUR rules. Thus, the decision-making body prior to adopting the secondary rules must consult with the Parliament of MERCOSUR. Furthermore, the Parliament of MERCOSUR has the right to propose draft rules to the CMC, in particular rules dealing with the harmonization or mutual recognition of the state parties’ national legislation. From this description, it seems to the author that the Parliament of MERCOSUR has no binding authority and it is contrary to the essence of the parliament body. In substance, the Parliament’s tasks of monitoring legislative power are very limited and do not change the intergovernmental character of MERCOSURE. Although the Parliament of MERCOSUR represents the people of MERCOSURE but it is only a label imbedded with no decision-making authority. However, compared to ASEAN, the author notes that the creation of a Parliament like MERCOSUR has, but with more legislative powers, should be considered as a step forward in the development of the institutional structure of the organization.

MERCOSURE has also established the Permanent Review Court/Permanent Tribunal Review (TPR) under the Protocol of Olivos in 2002, whose objectives were to interpret MERCOSURE regulations and settle trade disputes. However, it seems to the author that MERCOSUR is just like ASEAN, which lacks institutional mechanisms and regulations to be transposed into national laws. Although MERCOSUR has a dispute-settlement mechanism, the author observes that it also lacks a clear binding endorsement mechanism. This can be seen in Article 7 of the Olivos Protocol as follows:

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532 See Protocol of Ouro Preto Art. 9.
533 See the Constitutive Protocol for the establishment of MERCOSUR Parliament, signed on December 9, 2005.
“1. If the dispute was submitted to the Common Market Group of States parties to the dispute, it shall make recommendations, if possible, be explicit, detailed solution aimed at difference or.

7. If the dispute is brought to the consideration of the Common Market Group at the request of a State not party to it, the Common Market Group may make comments or recommendations.”

It seems to the author that the intervention of the CMG by issuing recommendations shows that the dispute mechanism is still influenced by its intergovernmental character. Furthermore, with regard to the role of TPR, Bartesaghi criticizes that to make a powerful TPR, the members must take a necessary step by changing its intergovernmental character to community law, a step that will create a full-fledged Permanent Court of Justice. Nevertheless, the creation of Parliament MERCOSUR and TPR and inclusion of the possibility that this may solve consultative opinions, are efforts to endow the process with a certain degree of “supranationality”.

From the description above, the author concludes that there are similarities between ASEAN and MERCOSUR. Both have similar intergovernmental character, similar regulation on dispute settlement mechanisms and the same lack of effective mechanisms to deepen economic integration. There are also differences, in the author’s opinion, namely:

- First, the establishment of ASEAN was initially based on security and political interest. A former Singapore Prime Minister, Lee Kuan Yew, in his insightful book has a wise statement:

  “While ASEAN’s declared objectives were economic, social, and culture, all knew that progress in economic cooperation would be slow. We were banding together more for political objectives, stability and security, but as expected, initially there was little tangible progress.”

Another scholar, Stuart Harris, also formulated a good statement with regard to the background of the ASEAN’s objective:

“ASEAN’s objectives were never primarily economic, however, but involved security and then political influence. It was initially concerned with internal security objectives (to avoid existing territorial and border disputes or challenges to national legitimacies becoming military

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conflicts). Judged on its ostensible economic objectives, ASEAN’s achievements have been limited.”

From the opinion of these two scholars, the author concludes that the main objectives of ASEAN are more related to security and political issues rather than economic and social issues. 541

Meanwhile, MERCOSUR’s establishment was based on economic interest and started with the Argentine – Brazilian integration, but both nations have the same initiative originating from the leader/policy maker. Furthermore, the two organizations have the same intergovernmental character, but pose a reluctance in transferring their sovereignty to their respective organizations.

- Secondly, the willingness to reform the intergovernmental character in MERCOSUR is initiated by the weaker members, while in ASEAN it comes from some of the founding members. This is exposed by Gabriel Gary who points out that the establishment of MERCOSUR was the result of bilateral negotiations between Argentina and Brazil initiated in the mid-1980s, which took on board Paraguay and Uruguay at the very last minute. 542 The latecomers had little opportunity to exert any significant influence during the drafting process of the Treaty of Asuncion to ensure provisions are favourable to their national interests. 543 Other scholars also see that the member states of MERCOSUR, particularly Argentina and Brazil, want the maximum of economic and politic benefits from integration, while foregoing as little sovereignty as possible. 544

What could be learnt from the MERCOSURs’ experience to further development of an ASEAN economic integration? There are several points that can be taken into consideration.

- The attempt to lessen regional asymmetry. MERCOSUR was focusing on technical and financial assistance for members with relatively lower or weak development. In this case, ASEAN has already implemented it by designing the Narrowing Development Gap (NDG) project in July 2001 when ASEAN announced the Hanoi Declaration on Narrowing Development Gap for Closer ASEAN Integration. This was called the Initiative for ASEAN Integration (IAI) to narrow the development divide and enhance ASEAN’s competitiveness as a region to provide a framework for regional cooperation

541 It had been proved that the establishment of ASEAN due to decolonization from foreign powers.
through which the more developed ASEAN members could help those member countries that most need it.\textsuperscript{545} ASEAN also has a Roadmap for the AEC 2015 which provides research and capacity building support to strengthen the research capabilities and human capital development of each ASEAN Member Country and to establish appropriate capacity building programs to assist newer member countries to enhance the development and regulatory frameworks of their financial markets.\textsuperscript{546}

- The role of NGO and/or Non State Actors in MERCOSUR is important for the resolution of the programs in the region. For example, they helped MERCOSUR in the creation of the MERCOSUR Cultural Network, which includes more than 400 members, and also with the Coordination of Trade Union Centres of Cono Sur, which has a constant presence in the official meetings of MERCOSUR.\textsuperscript{547} ASEAN also has a partnership with the Civil Society Organization (CSO) and with the NGO, for certain projects such as ASEAN-ROK on home care for old people as well as with the CSO on the ASEAN Human Rights Declaration.\textsuperscript{548}

- The transfer sovereignty of the government to a supranational body is one of the obstacles to achieve economic integration in MERCOSUR. ASEAN has the same problems. The reluctance of leaving the comfort zone to some of the member states becomes a hindrance to deepen economic integration.

The author also points out that these two organizations have similar problems, especially on the willingness to transfer sovereignty to international organization. However, ASEAN has made a significant achievement in its organization in the face of the ASEAN economic integration by having the ASEAN Charter. However, the Charter also needs to be reformed over time.

Moreover, according to Guerrero, the establishment of AFTA in 1992 was the first significant move, to face the AEC 2015.\textsuperscript{549} Many agreements have already been made,

\textsuperscript{545}The IAI initiative was launched in 2000 by the Head of the ASEAN Leaders. See further at http://www.asean.org/communities/asean-economic-community/category/overview-ndg-iai-iai-work-plan-iai-task-force-idcf
\textsuperscript{546}last accessed on January 22, 2015.
especially the economic agreements to face the AEC 2015. Many interactions have been made as well between the members, not only between states, but also between their residents.

Furthermore, Luhulima also points out that by agreeing to enter into a regional association, the ASEAN member states should have implicitly or appropriately shared some of their sovereignty and thus consented to the diminishing role of the nation state. They have reordered sovereignty at the regional and national levels.\textsuperscript{550} Furthermore, he also states that:

“With the proliferation of multilateral treaties regulating a growing number of issues and the rapid expansion of a body of international declarations, statements, resolutions and other instruments of what is now called “soft” law, more and more issues that were once considered domestic are now treated as legitimate international concerns: rule of law, good governance, the principles of democracy and constitutional government…”\textsuperscript{551}

In addition, Severino states that the recommendations of the High-Level Task Force on ASEAN Economic Integration on compliance bodies and procedures and on a dispute settlement system for the ASEAN economic agreements are unquestionably on the right track.\textsuperscript{552} He also points out that in order to promote the ASEAN economic integration and other forms of regional cooperation, the ASEAN Secretariat has to be empowered and fortified to take initiatives, for the approval of the member-states, on the basis of studies that it does or commissions.\textsuperscript{553} Besides, he also underlines that these can be overcome only with a stronger sense of region, as well as through bilateral efforts and financial support.\textsuperscript{554} The author agrees with his emphases. The author also argues that by committing to endorse their sovereignty, capacity and authority to some degree to the association or the Secretariat, ASEAN itself should considerably be aware of the needs for supervision and legal certainty of their activities with regard to the agreements that may cause conflict of law issues. It is not an easy task and is going to be a long-term effort for the ASEAN member states. However, it has to start soon.

The author also concludes that from the EU and MERCOSURE perspective, there are lots of things that could be learnt from them, but one thing is for sure that ASEAN cannot be compared with the EU or MERCOSURE, because they are all different from one another. Severino has pointed out the difference between ASEAN and the EU as follows.\textsuperscript{555}


\textsuperscript{551}Ibid.

\textsuperscript{552}Rodolfo C. Severino, “Southeast ASIA In Search of an ASEAN Community”, \textit{Opcit.}, pp. 377.

\textsuperscript{553}Ibid.

\textsuperscript{554}Ibid., pp. 378.

\textsuperscript{555}Ibid., pp. 11.
"As I recalled earlier, the Bangkok Declaration, ASEAN’s founding document, was a simple declaration of intent. It was not couched in legal terms, set up no regional institutions, and was not binding in a legal sense. In contrast, the Organization of American States and the African Union, like the European Union, are much more structured, with a Charter in the case of the OAS and a Constitutive Acts in the case of the AU and clear and elaborate rules of procedure in both cases."

The author concludes that ASEAN and the EU will never be able to compare the way they manage their regions because from the beginning of their establishment, they are both already different. ASEAN commenced from the members which had been under colonialism and was initiated by the elite powers based on security reasons with an informal approach, while the EU started from the Soviet Union’s threat and the willingness of making a cooperation with the United States (economics basis), not to mention that the EU began with a supranational authority with powerful supranational institutions such as the European Central Bank, European Parliament and a Court of Justice. They all have powerful authority to run the administration through treaties and statutes.

So, it appears to the author that ASEAN could not use the EU model as a whole because ASEAN itself is unique to its region and has its regional identity. The author argues that ASEAN may learn from the EU, especially from its structural and legal perspective. Moreover, on top of that, one crucial point is that there should be a willingness and a full commitment of the ASEAN leaders and their administration, a sense of belonging, to implement together an economic integration with legal certainty and structured organs to face the AEC 2015. The author realizes that this is a very delicate issue and it is going to take a long time due to some reluctance at the beginning and the need for a huge reform and the same perspectives of the member states to do that. Nevertheless, this reformation should be taken into consideration by the member states.

3. Summary

This chapter describes the background of ASEAN and its development, which was initially from the security and political interest and then ASEAN tried to achieve its economies’ goals by creating the AEC. The author concludes that ASEAN’s economic recent goal was to increase its role in economic development and mutual assistance and the latest effort was to create the AEC in 2015. These goals were mostly created and initiated by means of a declaration by the leaders, like the Bangkok Declaration, the Manila Declaration, the Cebu Declaration, and the Declaration of ASEAN Concord or Bali Concord. The author sees that these declarations are not legally binding to the ASEAN member states. Since ASEAN uses a diplomatic strategy based on consultation and consensus, then the use of declarations fits to the ASEAN’s characteristic, but it should be reformed to provide more legal certainty.
ASEAN has also created a treaty, such as the Treaty of Amity and Cooperation (TAC), but since then there has not been any new treaty until now.

During the ASEAN financial crisis in 1997, which caused disunity in the ASEAN economy, the principle of non-interference was not able to help ASEAN to bounce back from the turmoil. As of the beginning of the crisis, ASEAN has been willing to recover and develop its economy, by attaining the AEC 2015. Scholars and professional support for ASEAN’s interest, to transform from conventional arrangements to forward-thinking means. The economic integration and cross-border payment systems need a wide-range institutional mechanism, infrastructure, and mostly sound regulations which are applicable to all jurisdictions. These regulations should be legally binding and enforceable in order to provide legal certainty to all the ASEAN member states.

Moreover, the regional power should be broadened to cover the national level as well. The author concludes that the ASEAN Charter is an example by providing a legal personality for the Association, but there is still a need for further reform, since the contents should provide a bigger role and power to the ASEAN Secretariat to represent all the ASEAN member states, by designing and empowering the institution and the infrastructure of ASEAN with the authority to make policies and regulations, to take decisions and to impose sanctions.
CHAPTER 4

A LEGAL BASIS AND KEY ISSUES FOR AN RTGS INTEGRATION INITIATIVE IN ASEAN

1. The Possible Arrangement for an RTGS Integration in ASEAN

1.1 Introduction

As described in the beginning, globalization does not only impact the European and American continents but also the South East Asian region. The impact itself is not only in terms of political reforms, but also in economic, social and cultural reforms. The history of the establishment of the European Union and ASEAN has already been illustrated. From such description, it follows that the European Union has a supranational institution, known as the ECB, which has the power and authority for monetary policy and payment systems within the EU member states. It has been proven that the ECB is already successful in integrating cross-border payments within the Euro member states by using TARGET.

In this chapter, the author will make an analysis based on a legal normative approach as follows: would it be possible for ASEAN to follow the success of the EU in arranging an efficient and safe cross-border payment system within the region, not only from the legal perspective but also with regards to the requirements for making a unification of regulations by learning from the EU regarding the cross-border payment system. It will also explains the challenges to create a unification of law on the RTGS integration within the ASEAN region.

1.2 The AEC Blueprint and The Working Committee on Payment System and Settlement (the WC-PSS)

In January 2007, there was a Declaration by the ASEAN Leaders of the member states affirming their commitment to the creation of the AEC by adopting the ASEAN Economic Community Blueprint, in Singapore. In 2009, there was the Cha-am Hua Hin Declaration on the Roadmap for the ASEAN Community (2009-2015) in Thailand, emphasizing on narrowing the development gap to ensure the benefits of ASEAN. Under the roadmap of the AEC, methods and milestones have been categorized in areas which are considered essential to economics and monetary integration, namely (a) capital market development; (b) capital account liberalization; (c) financial services liberalization; and (d) ASEAN Currency Cooperation. This commitment, according to the author, has consequences for the

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558 See further on AEC Blueprint. The detail information of the roadmap of the AEC will further discussed on the next sub chapter.
economic integration of the ASEAN region, which needs more comprehensive cooperation amongst the national state to shift into a regional state.

The different levels of development between the member states of ASEAN, which are economically, legally and technologically quite diverse, have been measured. Thus, for achieving the AEC by 2015, the respective member states realize that their high priority is to make preparations and to speed up the regional financial integration in achieving the standardized/common requirements within the ASEAN region. Therefore, they decided to carry out a financial outlook to identify the gap that impedes financial integration by making comprehensive timelines, schedules and stages to be implemented by the respective member states depending on their readiness in terms of the quality of their financial infrastructure.\textsuperscript{559}

1.2.1 The Roadmap for Financial Integration of ASEAN: An Economic Perspective

As already described in the previous chapter, the financial crisis of 1997 was a shockwave as well as an initial step to get up and work together more intensively for ASEAN. The financial crisis shock and panic at that time in Thailand, due to Baht’s devaluation, affected other neighbour members, like Malaysia, Indonesia and the Philippines.\textsuperscript{560} From these domino effects of the crisis in 1998, the ASEAN member states, through the ASEAN Finance Ministers (AFM), agreed to work together side by side and they had a closer dialogue on economic and monetary policies, known as the ASEAN Surveillance Process (ASP).

The ASP started in 1999 as a mechanism for peer review and exchange of views among the senior officials and Finance Ministers on recent economic developments and policy issues in ASEAN.\textsuperscript{561}

The objective of the ASP is to strengthen cooperation by:\textsuperscript{562}

- exchanging information and discussing economic and financial development of member states in the region;
- providing an early warning system and a peer review process to enhance macroeconomic stability and the financial system in the region;
- highlighting possible policy options and encouraging early unilateral or collective actions to prevent a crisis; and

\textsuperscript{560}See Urbi Garay, Op cit. See Chapter 3 sub chapter 1.6.
monitoring and discussing global economic and financial developments which could have implications on the region and propose possible regional and national level actions.”

Since then, there has been an escalation of cooperation within the ASEAN member states with regard to the economic issues, in order to recover from the global crisis and to strengthen the economy at regional level. The author has observed that this achievement became one of the commitments to financial integration under the AEC blueprint in order to enhance financial resilience and competitiveness in the region by having greater integration of the financial market.

The roadmap was defined and elaborated as follows:563

1.2.1.1 Capital Market Development

In this area, the ASM agreed to broaden and deepen the regional capital markets by building an integrated regional capital market to enhance market access, liquidity, and linkages. The measures to be undertaken are establishing the trading and settlement infrastructure, and also strengthening coordination and surveillance at both regional and domestic levels.

1.2.1.2 Capital Account Liberalization

The ASEAN member states have concluded their self-assessment and identification of rules appropriate for liberalization of regulation related to foreign direct investment (FDI). This reaffirmed their commitment to capital account liberalization.

1.2.1.3 Financial Services Liberalization

Realizing the dissimilar level of financial services development among the ASEAN member states, they agreed to undertake a study to identify the gaps and constraints that hamper financial integration. In 2010, a new modality for financial services liberalization, based on pre-agreed flexibilities, was endorsed by the Finance Ministers.564

1.2.1.4 ASEAN Currency Cooperation

This cooperation will support and facilitate intra-regional trade, investment and economic integration through some currency arrangements. The efforts will be made toward maintaining

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563 See “Regional Cooperation in Finance”, Op cit.
564 Ibid.
1.2.2 The Establishment of the ASEAN Working Committee on Payment and Settlement System (WC-PSS)

From the above description, there is nothing stated literally and specifically about the development of cross-border payment and settlement systems becoming part of the economic integration. The AFM meeting only provided the wide-range steps of implementation related to financial integration. Therefore, the ASEAN Central Bank Governors also had the same viewpoint at the ASEAN Central Bank Governors Meeting in Vietnam in supporting the AEC 2015. They discussed the implementation of the ASEAN Financial and Monetary Integration Roadmap, as well as cooperation between ASEAN and the three dialogue partners including China, Japan, and South Korea. Yan Meng reported that the governors made a statement and commitment to take actions to facilitate the ASEAN commercial transactions. The Governors therefore, came up with more comprehensive thoughts and more specific ideas.

In April 2010, they decided to set up the ASEAN Central Banks’ Working Committee on Payment and Settlement Systems (WC-PSS) aiming to identify areas of improvement requiring Payment and Settlement System (PSS) development among the ASEAN countries and to formulate recommendations for the member countries where relevant. This will support the integration of the members’ economies under the AEC 2015 Blueprint and beyond.

In September 2010, the WC-PSS achieved its objective, which is to prepare the payment and settlement systems (PSS) of the ASEAN member countries in view of the AEC in 2015, by conducting studies and providing policy recommendations for the development of the PSS and the cooperation as well as the harmonization of the ASEAN PSS. The Asian Development Bank (ADB) in its study identified that the ASEAN Governors in the ASEAN Central Bank Governors’ meeting in April 2011 had emphasized the necessity for financial integration to support the regional economy.

\[\text{\textsuperscript{565}ibid.}\]

\[\text{\textsuperscript{566}See Chapter 4 sub 1.2.1. See further detail on the Roadmap of the AEC.}\]


\[\text{\textsuperscript{569}See ASEAN-WCPSS website, at http://www.aseanwcpss.org/aseanwcpss/Pages/About.aspx, last accessed on January 28, 2015.}\]
economic integration to develop ASEAN into a leading growth region. The author argues that their decision is in accordance with the objectives of the ASEAN financial integration and supports the programs set forth in the AEC Blueprint.

Moreover, based on the ASEAN WC-PSS report in April 2011, the WC-PSS already identified five key elements to be examined i.e. policy, legal framework, instrument, institution, and infrastructure. The WC-PSS has also determined five areas for future enhancement, development and harmonization, namely cross-border trade settlement, cross-border money remittance, cross-border retail payment systems, cross-border capital market settlement and standardization. They also laid out a roadmap for short term, medium-term and long-term recommendations (See Table 3).

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<tbody>
<tr>
<td>Standardization</td>
<td>Individual studies have identified many areas of PSS that require greater standardization, formalization and harmonization. There are international standards that exist for some areas, while in other areas it would fall upon members to identify best practices as a benchmark for services in the region. One key area under the ‘Standardization’ study is that ASEAN should look to adopt ISO 20022 for PSS for the financial services, which could, in the future, allow for more</td>
<td></td>
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<tr>
<td></td>
<td>In the medium term, when ASEAN has achieved some degree of standardization in the respective areas, members could work towards further improvements to PSS and market practices, in alignment with members' needs based on the outcome of the needs analysis. Specific initiatives include moving towards T+1 receipt of funds and improving infrastructure by establishing or expanding links in existing payment systems (e.g. APN).</td>
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<td></td>
<td>In the longer term, the goal might be to achieve same day funds transfer within the region. This long-term goal would ultimately require linkages to be formed between the various payments systems be it for retail payments, trade settlement or money remittance. At this point, the region is expected to have enhanced or developed systems that are interoperable since they adopt similar standards. What remains is to determine the form of linkages within ASEAN for</td>
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</table>


571 These objectives are taking into consideration the different timelines and milestones for each AMS, and the readiness of each members’ financial infrastructure (especially for the BCMLV) to implement the programs/plan which drafted by the WC-PSS.

572 See further “Strategic Report to the ASEAN Central Bank Governors Meeting”, Op cit.
| Cross-border Trade Settlement | The study proposed to create more transparency regarding the disclosure of bank charges (such as foreign exchange spread, handling fees) for cross-border banking. Greater disclosure of charges will reduce the cost of intra-ASEAN trade particularly when transacting in foreign exchange; The region would see benefits when local currency transaction costs are brought down due to greater information and greater competition amongst banks. | For ASEAN to study possible mechanisms to achieve T+1 receipt of funds for cross-border payments. The study also recommended promoting local currency settlement of trade through bilateral linkages amongst ASEAN 5 in line with member states’ relaxation of access to domestic currencies. | each PSS area, which would constitute the long-term work goal of WCPSS. An example identified in the studies is the region’s eventual participation in Continuous Linked Settlement (CLS) that would reduce FX settlement risk. Other linkages could be between automated clearing houses, RTGS or other. |
| Money Remittance | In this study, proposals were for the adoption of policies to promote the use of formal/regulated channels, as well as greater transparency of remittance charges in enhancing consumer protection. Central banks could encourage the participation of regulated non-bank remittance service providers that could enter into rural unbanked areas. | The study proposed exploring the feasibility of utilizing existing regional networks (APN) for money remittance and expanding its reach to other members. | |
| Retail Payment | This study highlighted that central banks should promote the adoption of international/common standards in retail payment systems as the foundation for interoperability between existing retail payment systems in the region. Moreover, to increase efficiency and to widen the usage of payment | WC-PSS should continue the initiative with facilitating the expansion of products, not only for ATM card, but also for debit card and credit card scheme, and services provided by the existing regional network, such as utilization for money remittance services. | |
instruments, central banks might facilitate the development of common used instruments under regional scheme for retail payment systems. In order to ensure the effectiveness of the initiative, joint research among central banks could be useful.

| Capital Market | The study proposed the adoption of international standards for straight through processing in domestic and cross-border settlements, and introducing risk mitigating measures such as delivery vs. payments and payment vs. payments if they are absent in certain domestic markets. | WC-PSS should work with the ASEAN Capital Market Forum (ACMF) and WC-Capital Market Development to assist in their respective implementation plans that might call upon WCPSS to help study various options for establishing regional infrastructure for capital market settlement. |

Source: the WC-PSS website, the author’s modification

The author notices that the WC-PSS is already aware which of the different conditions in each of the member countries become the first priority tasks to consider. From the table above, the author has observed that the standardization and capacity building within the member states are important parts of the goals for narrowing the gap among the member states. They decided to adopt ISO 20022 as a standard system that will be applied for a payment system mechanism.

1.2.3 Different Perspective between ASEAN and the EU on Payment Systems Development

There is one thing that the author finds necessary to comment on, i.e. the types of area developments of the WC-PSS Roadmap. They have five areas of development. They decided to develop Trade Settlement, Money Remittance, Retail Payment

573 Narrowing the gap means to have a same level playing field on payment systems infrastructure in order to be able to communicate among national payment systems. This can be seen that they decided to adopt ISO 20022 for the standard of financial services of PSS.

574 ISO 20022 is a multi-part International Standard for Financial Services Messaging, prepared by ISO Technical Committee TC68 Financial Services. It is a single standardization approach (methodology, process, repository) to be used by all financial standards initiatives. See further at http://www.iso20022.org/payments_messages.page, last accessed on January 28, 2015.
System, Capital Market Settlement, and Standardization to achieve the ASEAN Payment Vision which aims to foster integrated, safe and efficient payment settlement systems in the region that enable businesses and individuals to make or receive electronic payments with greater convenience.\(^575\) It is interesting to note that they have had a retail payment area for development but they did not explicitly mention a high value payment area (RTGS), which, from the author’s perspective, is also important as one of the areas for development. They did mention RTGS only as one of the options for supporting those five key areas of developments.\(^576\)

The author concludes that ASEAN has a different approach compared to the EU. In the EU, they first had thoughts to establish both a high value payment and a retail payment area in order to integrate the financial market, but they created and developed a high value payment (TARGET) as a first priority to support the single market in the EU and to facilitate the ECB’s monetary policy transactions as well as support trading transaction for the EU members, then followed by designing TARGET2 and developing TARGET2-S (T2S) for securities settlement.\(^577\) Simultaneously, they followed up to establish and develop a retail payment system, namely SEPA, to be integrated in entire Europe, which until now is still in the progress of development.\(^578\) In ASEAN, on the other hand, the WC-PSS has a key program to develop retail payment area but unfortunately not specifically as a program to develop a high value payment area, like the EU did. It appears to the author that RTGS in ASEAN was not a priority area of development from the beginning, like retail payment area, but only as a supporting tool to support those five keys area of development. The author sees that to reach the financial market integration in ASEAN and to facilitate the trades and investments program, the development of the high value payment area is more feasible and beneficial, than the development of the retail payment area.

Furthermore, the author also observes that the Trade and Capital Market area had already been explicitly stated and covered in the AEC Blueprint and repeated by the WC-PSS and it became an area of development, which, according to the author, should not be the main project areas for the WC-PSS to develop. Moreover, the author identifies that these two areas, especially Capital Market area, should be the main task of the Working Committee on the Capital Market Development (WC-

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\(^{576}\)See Table 3 in chapter 4 sub chapter 1.2.2.

\(^{577}\)See chapter 2 sub chapter 2. See further also the overview of TARGET2-S (T2S) at https://www.ecb.europa.eu/paym/t2s/about/about/html/index.en.html, last accessed on January 15, 2015. The T2S project was launched in 2008 and the platform is scheduled to start operations in 2015. T2S will not be discussed further.

Additionally, the author thinks that a high value payment system area (RTGS) should become a primary priority project to establish and develop in order to support the Trade and Capital Market that have already been stated in the AEC Blueprint.

The author is not in line with the WC-PSS’s policy, regarding the High Value payment system area. The author thinks that it should be taken into consideration the high value payment system as a priority project, because indirectly it will provide the infrastructure/instrument for regional settlement of trade, capital market and retail payments as well. They should be more concerned and focused on the development of payment system area instead of other areas.

When looking at the EU’s experiences, from the beginning, the EU had already established TARGET (High Value Payment Mechanism/RTGS) in 1999 as a primary project to support the monetary policy to integrate the financial market within the EU members.\(^\text{579}\) Then, they consecutively followed up by developing retail payment (creating SEPA), which was enactment in 2008 and capital market settlement (creating TARGET2-Securities (T2S), which was enactment in 2014).\(^\text{580}\) With regard to TARGET, since the beginning of its operation in 1999, it has emerged as the major payment system instrument, settling on a yearly basis payment for more than 10 times the total GDP or the EU countries.\(^\text{581}\) As mentioned earlier, TARGET itself was chosen not based on the market or business need, but it was based on the policy makers which is set forth in the Treaty. It can be seen in Table 4 that the volume of transactions varies among the EU members at that time. Simonetta Rosati and Stefania Secola had analysed on Cross-Border TARGET flows in 2000, the first year after its commencement.\(^\text{582}\) (See table 4).

\(^{579}\)See chapter 2 sub chapter 2.

\(^{580}\)These two instruments started few years after TARGET. SEPA is a project to harmonize and to make and process retail payments in euro. The goal is to make payments in Euro and across Europe as fast, safe and efficient as national payments. There were two new SEPA instruments, introduced in 2008 (SEPA credit transfer) and 2009 (SEPA direct debit) and implemented in 2014. After 15 years of work (since 1999), the Single Euro Payments Area (SEPA) has been successfully implemented for credit transfers and direct debits in the Euro area. See further at http://www.ecb.europa.eu/paym/ retpaym/paymint/html/index.en.html, and see the ECB Press Release related to SEPA at http://www.ecb.europa.eu/press/pr/date/2014/html/pr140801.en.html, last accessed on September 16, 2014. The T2S (TARGET2-Securities) is a new European securities settlement engine, developed by the ECB from TARGET and TARGET2, which aims to offer centralized Delivery-versus-Payment (DvP) settlement in central bank funds across all European securities markets. This platform is scheduled to start operations in 2015. See further at https://www.ecb.europa.eu/paym/pdf/Sibos_2013_T2S.pdf ?ae822d00aacc5f95d4631b6682aac39, last accessed on January 28, 2015. Both SEPA and T2S will not be elaborated in this dissertation because the focus of this dissertation is on a high value payment system settlement.


\(^{582}\)Ibid, pp.10.
Table 4
EU Countries Key Figures

<table>
<thead>
<tr>
<th>Year : 2000</th>
<th>Cross-border TARGET flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>EUR Billions</td>
</tr>
<tr>
<td>Austria</td>
<td>2,594</td>
</tr>
<tr>
<td>Belgium</td>
<td>9,080</td>
</tr>
<tr>
<td>Germany</td>
<td>28,306</td>
</tr>
<tr>
<td>Denmark</td>
<td>1,432</td>
</tr>
<tr>
<td>Spain</td>
<td>4,096</td>
</tr>
<tr>
<td>Finland</td>
<td>1,533</td>
</tr>
<tr>
<td>France</td>
<td>15,352</td>
</tr>
<tr>
<td>UK</td>
<td>19,189</td>
</tr>
<tr>
<td>Greece</td>
<td>205</td>
</tr>
<tr>
<td>Ireland</td>
<td>1,406</td>
</tr>
<tr>
<td>Italy</td>
<td>9,308</td>
</tr>
<tr>
<td>Luxemburg</td>
<td>2,676</td>
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<tr>
<td>The Netherlands</td>
<td>9,859</td>
</tr>
<tr>
<td>Portugal</td>
<td>893</td>
</tr>
<tr>
<td>SE</td>
<td>1,718</td>
</tr>
<tr>
<td>total</td>
<td>107,647</td>
</tr>
</tbody>
</table>

Source: ECB- Simonetta Rosati and Stefania Secola – modified by author

The table above shows that the cross-border payment flows vary for every member. It shows, for example, that Germany contributed the largest share i.e. 26.3% (€28,306 billions) followed by the UK and France i.e. 17.8% (€19,189 billions) and 14.3% (€15,352 billions) respectively. The smallest shares belong to Greece, followed by Portugal and Ireland i.e. 0.2% (€205 billions), 0.8% (€893 billions), and 1.3% (€1,406 billions) respectively. In general, we can see that the leading economies (Germany, UK, and France) played an important role in term of financial markets. In particular, the UK shows an atypical condition, given the fact that it is a non-Euro area member state but could become a significant player at the EU level. In contrast, Italy, which is considered as one of the big EU countries, shows difference in condition, which is contradictive to its real economy, it has a share of 8.6% (€9,308 billions), and is, thus, smaller than the Netherlands which has a share of 9.2% (€9,859 billions). It can be concluded that at that time, TARGET was not created based on the demand of the market but because of the interest of the policy makers, to integrate the Euro market by creating a single market in the EU.

On the other hand, in order to see and compare the trade flows in ASEAN, the author also provides the below table, which depicts the export import flow transactions of Indonesia compared to other ASEAN countries as an example.
Table 5
Export Import Indonesia with other ASEAN Countries

<table>
<thead>
<tr>
<th>Year</th>
<th>Export 2013 (in thousand USD)</th>
<th>Import 2013 (in thousand USD)</th>
</tr>
</thead>
</table>

The table shows that the amount of transactions among the ASEAN members vary as well. It is illustrated that the biggest portion of trading is with Singapore and then followed by Malaysia, Thailand, and Vietnam. From these four countries, the average export import is above USD 200 million, while the other countries are under USD 100 million. By using this table, the author also wants to show that this data can be used as an approach to envisage the use of a cross-border payment system (RTGS) for ASEAN. By monitoring the data of cross-border transactions, the central banks can use that same data in the formulation of their policies in the context of capital flows management. The development of such an integrated system can also be useful in promoting the creation of a financial market within ASEAN. In the opinion of the author, the development of the integrated system, which is to facilitate trading transactions (such as the export-import transactions and the investment transactions among the ASEAN members) should become a priority because it will be way more beneficial for ASEAN compared to developing other payment systems.

By pointing to these figures, the author also wants to highlight that the background and the implementation of TARGET was derived from the EMI’s main tasks. In the other words, it is a top-down policy (driven by policy makers) to support and strengthen the financial market integration within the EU by providing a faster, safer, and easier cashless Euro payment throughout Europe. So, by observing the similarity of the variation in the amount of transactions above, the author thinks that the establishment of an integrated high value payment system (RTGS) can be also a top-down policy and should be considered as a priority project that will support and strengthen the financial market integration in order to attain the objectives of AEC 2015.
From these perspectives, the author believes that technically and economically the establishment and development of an RTGS area should become a priority compared to other areas, because such plan is more feasible, applicable, relevant and more beneficial to be implemented in the near future. The other objective is to support the integration of financial markets in ASEAN; not to mention its ease and effectiveness. Why it is easier and beneficial? The author’s argument for choosing the RTGS as an integrated payment system transactions\textsuperscript{583} is because it is more feasible and beneficial, hence, its implementation should be prioritized to support the purpose of the financial market and economy integration in ASEAN. The following are:

- Firstly, the RTGS is a worldwide payment system and is used in most countries for large-value payments\textsuperscript{584} including by the ASEAN member states, most of which already have the RTGS system, so the infrastructure itself already exists.\textsuperscript{585} They need to connect the RTGS of the respective members to communicate with each other, like the EU has already done with TARGET, but first of course they should have the same (standardized) platform by creating a design strategy and methodology for the integrated payment system. Picture 2 below provides the interlinking system that the author proposes to be implemented on the RTGS integration initiative for ASEAN. The name proposed for such an RTGS integrated payment system is ASEAN – Automated RTGS Transfer System (ASEAN-ARTS). The author also proposes that this interlinking should be discussed further by the working committee, which consists of technical and legal experts to formulate this connection in order to run the system smoothly.

\textsuperscript{583}See the history of the EU establishing TARGET, in Chapter 2 sub chapter 1 and 2.
\textsuperscript{585}The existing infrastructures are different for each RTGS in ASEAN, depending on the characteristics of each country, but it could be re-designed to fit the ASEAN characteristics. See the experience of the EU in Chapter 2 sub chapter 2.2. Myanmar has not used the RTGS yet.
Proposed Interlinking System for ASEAN-ARTS

Secondly, the RTGS system has an international common standard and procedures to be complied with, based on a rule and procedure published by the BIS, which is known as the Principle of Financial Market Infrastructure (PFMI) and/or the Core Principles – Systemically Important Payment System (CP-SIPS). These international common standards and procedures will make the interlinking among the ASEAN member states RTGS system easier, because they refer to the same standard scheme system.

Thirdly, by using an integrated-RTGS, besides supporting the financial market integration and facilitating trade transactions and investments, the central bankers will be able to monitor every type of transactions like seeing through a magnifying glass, so that it can be used to oversee, to support the central bank’s policy in the context of capital flow management, and maintain monetary and financial stability of respective NCBs.

Fourthly, this integrated RTGS can be further developed not only for trade transactions and settlements, but also to support the capital market or securities settlement (for payment vs payment and delivery vs payment, as stated in the capital market area of WC-PSS roadmap).

Last but not least, since the central banks are settlement agents and to meet the business needs for cross-border transactions, the creation of ASEAN –

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586 See Chapter 1 sub chapter 2.3 and 2.4.
588 The EU has developed TARGET into TARGET2 and still in progress for TARGET-2S for securities settlement. See foot note in Chapter 4 sub chapter 1.2.3.
Automated RTGS Transfer System (ASEAN-ARTS) is relevant. Since it is categorized as CP-SIPS, it needs a proper legal framework which directly applicable for the ASEAN member states.

The author concludes that the recommended high value payment system is more feasible, relevant, and practical. Therefore, it should be part of key areas of development and be prioritized to be implemented in the near future rather than a retail payment system area (such as a debit or credit card payment) or a capital market area. Retail payment systems, such as a card payment (debit or credit card), are dealt with between at least four parties (private companies), i.e., the electronic payment instruments players such as banks (the issuing bank and the acquiring bank), merchants, telecommunication providers, and other private companies like Visa, Master card, Diners and Amex (network providers). These last companies play a big role in the retail payment industry and are also business profit oriented. Considering many players that have to be dealt with, the author thinks that it will be more difficult and more time will be needed for the central banks to implement the integrated retail payment systems in the near future than the high value payment systems, because each of the parties will have their own interests.

Moreover, with regard to the capital market area, for developing and implementing in Indonesia as an example, Bank Indonesia (BI) as a member of WC-PSS should make a cooperation and coordination with other authorities. In this area, BI has no authority to regulate and control that area/industry although it is also part of BI concern regarding the securities settlement. Such an area is under another authority: the Capital Market Supervisory Agency, under the ministry of finance. Thus, BI must work together with other related institutions like the Financial Services Authority, which means, that it needs more bureaucracy (inter-department) and of course this will be time consuming. Additionally, the availability and utilization of capital market instruments in Indonesian is very limited compared to those in other countries and is not ready yet to be integrated. Furthermore, the author observes that the capital market area is not the main area of the WC-PSS since there is an independent working committee set up by the ASEAN Capital Market Forum (ACMF), namely the Working Committee on Capital Markets Development (WC-

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589 The abbreviation of ASEAN-ARTS is a creation of the author.
590 When we learn from the EU, the retail payment system integration is implemented later, which is almost a decade from the commencement of high value payment system (TARGET was in 1999) i.e. implemented and migrated to SEPA instrument since 2008 until 2016. See further at https://www.ecb.europa.eu/paym/sepa/about/html/index.en.html, last accessed on January 28, 2015. The integrated securities settlement is still in progress as well.
591 The issuing and acquiring card are usually, but not always, banks.
592 Now, since 2014, the capital market and banking industry are under the Otoritas Jasa Keuangan (OJK) or Financial Services Authority (FSA).
and this means that there is a possibility for an overlap between these two committees.

Besides, it also seems to the author that the establishment and the development of a retail payment system area and a capital market area will take a longer period of time than the time needed for the author’s proposal (high value payment system area). For these two areas, especially for the capital market area, in Indonesia, for example, the payment system authority (the Central Bank of Indonesia) should firstly co-ordinate internally with other national authorities (other related ministry departments) before working further with other ASEAN’s central banks. Therefore, it would be reasonable and wise to put the high value payment system (the creation of ASEAN-ARTS) as a priority and to be a part of key areas of developments in the WC-PSS roadmap.

Pertaining to the structure body of ASEAN-ARTS or other key areas of development, the author agrees that ASEAN does not have to adopt the whole or detailed methods like the EU when they created TARGET or SEPA with its all institutional bodies. This is because ASEAN will not, or at least not in the near future, become a region with full economic and monetary integration like the EU. So, the structure body itself, at first, does not have to be supranational. ASEAN may set up with a working committee or an institute responsible for ASEAN-ARTS’ development. Regarding the monetary integration, some scholars are optimistic that ASEAN will move to further deepen monetary integration. The author focuses on how ASEAN should make a structured legal framework for ASEAN-ARTS, like rules and procedures and how to implement it. Additionally, the author realizes that this initiative should consider the common objectives with different timelines and milestones for each country depending on its readiness and also take into account the economic and technical development gaps among the ASEAN member states.

The author also identifies several key issues that should be taken into consideration by ASEAN regarding this proposal. Besides the key issues, the legal framework of such proposal is also important to be aware of. So, the next sub chapter will discuss the legal framework and key issues which may arise in creating and developing this High Value Payment System (ASEAN-ARTS).

594 See “Regional Cooperation in Finance”, Op cit.
1.3 Legal Basis of ASEAN-ARTS Initiative

As we all already know, this initiative cannot be done with a flick of our fingers, but the author believes that this initiative is more feasible and workable, particularly since the system itself is owned and operated by central banks. In preparing this proposal we should also see and consider the key issues that may arise in developing the ASEAN-ARTS.

1.3.1 The Proposal of Integrated RTGS System for ASEAN (ASEAN-ARTS)

The author proposes the integration of the RTGS system (ASEAN-ARTS) by means of interlinking all national RTGS of the ASEAN member states.\footnote{This interlinking is inspired from TARGET of the EU.} It is feasible, according to the author, especially for a short period of preparation in order to face the AEC 2015. The author recommends that this system will be managed by the ASEAN WC-PSS and supported by technical and legal working groups, which will be developing the technical and legal architectures.

In order to “interlink” the RTGS system, respective national RTGS systems of AMS should ensure their particular characteristics to comply with the common procedures, and ensure compatibility of member states national RTGS system with international open communication standards\footnote{The latest system is complied with the ISO 20022 and using swift format.}, determined by WC-PSS or created by them in order to be able to exchange data securely and reliably and also allow payment orders to be transmitted from one system to another. To some degree, ASEAN may adopt the TARGET interlinking system user requirements\footnote{See further ECB, “TARGET Interlinking Specification”, ECB, November 2001 Edition, June 2002.}, which provide the requirements for the implementation of the interlinking system. ASEAN might adopt the same design strategy as TARGET, such as the user requirement references and building the system on decentralized individual RTGS based on the existing infrastructure. ASEAN might also adopt the methodology for exchanging information such as classification of messages and free format messages.

In principle, the ASEAN-ARTS would be a decentralized system performed by all National Central Bank of AMS. The system should be irrevocable and final. It should have a unique identifier type of transaction to allow message identification and facilitate error handling. The procedures used for communication among interlinking components should include features safeguarding against hazards to integrity, authentication and non-repudiation. The system must have a contingency plan in the event of a disruption of the network and have security features, which provide a certain level security that must be defined for the system as a whole. So, the main goals of the ASEAN-ARTS initiative are to achieve a fast transaction and secure communication between these components and to support the economic
integration by enabling businesses and individuals to make or receive electronic payments with greater convenience. Moreover, at the big picture, the ultimate goal is to support and strengthen the financial markets and to facilitate trade transactions and investment in order to meet the objectives of the AEC 2015.

1.3.2 ASEAN Legal Instruments: Hard Law vs. Soft Law

One of the purposes of ASEAN is to create a single market with effective facilitation of trade and investment.\(^{599}\) It is obvious that the ASEAN Leaders have already considered the need of economic integration in order to strengthen the economy region and to make the business more efficient and effective. One of the characteristics of economic integration is free flow of goods, services and investment. This free flow requires legislation through technical regulations,\(^{600}\) ASEAN needs legislation in order to ensure legal certainty among the member states. In order for members to comply with standardization, it needs a legal instrument to legally bind them.

Interestingly, ASEAN has a unique characteristic which is regarded as a lack of binding arrangements because reliance on informal meeting and consensus mechanism. The way to achieve an agreement is more by way of *musyawarah* and *mufakat* (negotiation for consensus)\(^{601}\) rather than by court/formal decision.

The former Prime Minister of Singapore, Lee Kwan Yew, reaffirmed that:

> "ASEAN had made progress in an Asian manner, not through rules and regulations, but through musyawarah and consensus. Most important, ASEAN countries have made a habit of working together and of consulting each other over common problems." \(^{602}\)

ASEAN has improved rapidly by having a lot of legal instruments explicitly stated in the ASEAN Charter, namely declarations, agreements, conventions, concords and

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\(^{599}\)See Article 1(5) of the ASEAN Charter.

\(^{600}\)This is why the EU has Treaties, Statute and Directive to provide a legal certainty for its member states.

\(^{601}\)Based on Koichi Kawamura’s paper, “Consensus and Democracy in Indonesia: Musyawarah-Mufakat Revisited”, *Institute of Developing Economies, Discussion Paper no.308, 2011*. Musyawarah dan Mufakat is (deliberation and consensus) are a traditional decision-making rule in Indonesia which has often been observed in village meetings. This process is in order to achieve mutual agreement or to solve the problem in order to make decisions together in the settlement or solution of the problem. On the other hand, this system of musyawarah-mufakat decreases political efficiency in the sense that it takes a long time to deliberate drafted laws in the parliament. See further at http://ir.id.go.jp/dspace/bitstream/2344/1091/1/ARRIDE_Discussion_No.308_kawamura.pdf, last accessed on January 28, 2015.

Moreover, other legal terms have also been used besides those stated in the Charter, such as Joint Communique, MoU, memorandum of cooperation and protocol.

Practically, ASEAN has a lot of arrangements regulated by Memorandum of Understanding (MoU), multilateral and/or bilateral agreements. This can be seen in the arrangements on FTA, ASEAN 3+ and ASEAN Single Window.

Like other projects, the ASEAN-ARTS initiative will of course need a sound legal basis in order to have a rule of law. But, the author observes that to create this initiative by using MoU is ambiguous and confusing. The author proposes to use a treaty to provide legal certainty to this project and embrace all instruments binding at international law. ASEAN seems to seldom create a treaty for new policy/project or arrangements. In addition, the author observes that they have used many terms of legal instruments, which may cause harm to them and create confusion. According to Article 52(1) of the ASEAN Charter, it stated that all treaties, conventions, concords, declarations, protocols and other ASEAN instruments which have been used before shall continue to be valid. It seems to the author that ASEAN should homogenize its legal instrument become a structured legislation in order to simplify and to ease the member states to implement it in the future.

Back to the economic integration and the single market where there will be no barriers within the ASEAN member states upon the commencement of AEC in 2015, the need for payment services, such as the ASEAN-ARTS initiative and retail payment are essential for the creation and development of the internal market in ASEAN so as to ensure smooth and free movement of goods, services and capital or investment. The need for smooth, fast and safe operation of the single market in payment services is also crucial because it deals with financial risks and it needs legal certainty that has a legally binding effect to the parties. Therefore, ASEAN urges to establish a legal basis for payment services at the community level, to ensure a level playing field for all payment systems, for all the ASEAN member states to comply with. The lessons learned from the EU have provided treaties and directives

603 See Article 2(1) of the ASEAN Charter.
605 Ibid., United Nations Website.
606 ASEAN from its commencement until now, only have two treaties (using term ‘treaty’) i.e. Treaty of Amity and Cooperation (1976) and Treaty on the Southeast Asia Nuclear Weapon-Free Zone (1995). Others are using Concord, Charter, Declaration, and Convention which make confusing.
607 They have lots of terms of legal instruments according to Article 52 (1) the Charter: treaties, conventions, agreements, concords, declarations, protocols and other ASEAN instruments, such as, plan and MoU.
to govern that condition. Moreover, the EU even puts tasks to the ESCB, the ECB and the NCB to promote the smoothing of a payment system in the form of treaty and statute as the legal umbrella in this regard. All of these regulations are legally binding.

When looking at ASEAN, they make legal instrument for attaining its aims, which can be categorized into two types of legal instruments. The first one is known as the hard law, which has a direct binding effect such as charter, agreement, protocol, convention and treaty. The second one is called the soft law, which is known as a non-binding instrument e.g. declaration and MoU, but under the moral force the ASEAN member states should comply with it.

The author is inspired by the insights of Jakob de Haan, et al., in relation to the use of instrument of law when they analysed the Stability and Growth Pact (SGP) from the political economy perspective, focusing on the choice for soft law and drawing inferences from characteristics of successful fiscal rules at the state level in the US. The reasons for using soft law are as follows:

"First, soft law reduces negotiating costs which may make agreement possible. Secondly, soft law may reduce sovereignty costs, which states can limit the cost through arrangement that are non-binding or imprecise or that do not delegate extensive powers. Thirdly, in case of considerable “uncertainty”, soft law may be the most appropriate method of legislation. Lastly, soft law is a tool of compromise which provides flexibility in implementation."

The author agrees with their opinion that it is sometimes soft law, known as a compromising instrument of law because its flexibility in implementation. Soft law instruments are also usually considered as a potential stepping-stone for transforming into hard law in the forthcoming period.

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609 See Article 105(2) TEC (was amended by Article 127(2) (TFEU)) and Article 22 of the Statute of the European System of Central Banks and of the European Central Bank.
610 United Nations Website, Opcit. The term of Declaration according to UN, are not always legally binding.
612 Ibid.
613 For example, the Universal Declaration on Human Rights (UDHR) which was adopted by the United Nations General Assembly in 1948, and after eighteen years later, in 1966 had been drafted into two treaties by the representatives of the governments sitting down together in the UN and agreed on making the treaties i.e. the International Covenant on Economic, Social and Cultural Rights (ICESCR) and the International Covenant on Civil and Political Rights (ICCPR). Since then, they become legally binding by countries that agreed to become parties to them.
The author observes that ASEAN in these circumstances and based on its characteristics, seem to prefer using soft law at the beginning because it is easier to reach a mutual understanding and can be reassessed over time, but particularly, because it has no strong legal impact. It had been attested from the step of ASEAN Declaration known as Bangkok Declaration in 1967 that the ASEAN Leaders affirmed their commitments to cooperate for regional interests and forty years later, in 2007, some issues have been adopted in the ASEAN Charter and became a legally binding instrument. The author argues that ASEAN is more comfortable using soft law than hard law. It seems to the author that soft law is more dynamic for the ASEAN Leaders in a sense that it can still be adjusted and reassessed before it is turned into a hard law, but this thought might be more suitable for the problems related to politics in that era where “informal resolution” was best fit for such situation at that time. But later, soft law did not help them when disputes arise and they were seeking for international fora to settle their dispute.

For almost three decades after its establishment, ASEAN experienced increasing economic cooperation through the creation of the Framework Agreement on Enhancing ASEAN Economic Cooperation 1992 which is also considered as an ASEAN instrument containing dispute settlement mechanisms, as provided in Article 9, which states614:

\[\text{“Any differences between the member states concerning the interpretation or application of this Agreement or any arrangements arising therefrom shall, as far as possible, be settled amicably between the parties. Whenever necessary, an appropriate body shall be designated for the settlement of disputes”}\]

This Article was expressively broadened by a Protocol on Dispute Settlement Mechanism in 1996, which was then perfected by the ASEAN Protocol on Enhanced Dispute Settlement Mechanism of 2004615 (the “Vientiane Protocol”). From this perspective, the author observes that the necessity of legal certainty becomes one of the considerations of ASEAN and indeed, the author agrees that it is urgently required for this cooperation. One of ASEAN’s aims at first was to accelerate the economic growth and to promote regional peace and stability, as stated on the Bangkok Declaration. It definitely did not mention any mechanism to achieve this aim. However, after almost three decades, ASEAN has achieved the ability to maintain peace and security in the region and realized that it is about time to concentrate on domestic issues and put more effort into economic development, so

the economic sector must be prioritized. ASEAN’s success in handling politics and security disputes must be followed in the economic sector, but this sector, according to the author, should be treated in a different manner and with stronger legal framework. To support and promote economic development in ASEAN, it is really crucial to have a sound legal basis in order to provide legal certainty by creating a binding dispute settlement mechanism as the instrument to resolve any legal conflict, which may arise from economic cooperation. ASEAN needs a legal dispute instrument covering all the legal problems, especially in economic matters. Then, this was followed by the commitment of the ASEAN Senior Law Official Meeting (ASLOM) in 2004. This was stated in point 15 of the Joint Press Statement of the 9th ASEAN Senior Law Officials Meeting (ASLOM) 23-24 August 2004, Brunei Darussalam: 616

“The 9th ASLOM discussed and agreed that there can be continuing exchange of views and experiences between ASEAN Member Countries on the harmonization of intellectual property rights, trade laws, legal cooperation in alternative dispute resolutions such as conciliation and mediation and on ways to streamline the procedures for the legalization of documents.”

In this commitment, the author observes that the alternative dispute resolutions that they proposed still put emphasis on using of conciliation and mediation, which according to the author are less enforceable. 617 However, it demonstrates that the requirements of a legally binding approach are increasing, but again, it needs full support and commitment from all elements of every ASEAN member states, especially the leaders of ASEAN. The question is, why is it crucially needed? Because the author notes that the member states are still reluctant to use the DSM and prefer going to other fora to seek justice in solving their problem with a definite decision, not merely a win-win solution. 618 The author observes that in some cases, the member states need a certain and binding decision from an impartial decision maker which can be enforced, so that both parties must comply with the decision, even if one party will lose its rights – a legal certainty which apparently they would not encounter in their own dispute settlement mechanism. It seems to the author that ASEAN would appear less respectable by other countries outside its region for not trusting its own dispute settlement mechanism.

617 This will be further analyzed by the author on the next sub chapter related to alternative dispute resolution mechanisms.
618 See chapter 3 sub chapter 2.7.
Since the enactment of the ASEAN Charter and towards the AEC 2015, expediting the process of integrating hard law in its legislation becomes the critical stepping point for the ASEAN member states. Why? There are some issues according to the author, with regard to the need for hard law, such as:

- The creation of a single market will give people the freedom with no frontier to trade goods, invest their money and to enjoy it in conditions of security and justice accessible to all, and accordingly, they also will need the rules of law to carry out and to protect their activities. Thus, they need policies and laws designed to unify the diverse national interests; they need a law that governs and binds them and can be accepted and obeyed by all member states. By having a unified and legal binding regulation in the regional level and transposed into standardized national regulations, it will make the single market program easier to implement in ASEAN and consequently will stimulate economic growth.

- Integration is associated with international relations, thus entails standardization, uniformity or harmonization, sanctions and enforcement, because many participants are involved from different nations and different legal systems.

- The ASEAN Charter has already provided the settlement of dispute clauses. The author argues that ASEAN has already taken a risk by setting out the dispute settlement clauses in the Charter in order to strengthen the authority of the organization beyond the national interests, although there was still lack of implementation in using these dispute mechanisms. Nevertheless, these articles are expected to become a starting point to create more legally binding instruments that can enforce judgment efficiently and effectively.

Regarding the ASEAN Charter, on the one hand, the Charter has already made its position by providing a legal personality and the settlement of disputes clauses, which encourage establishing hard law as legal instrument. On the other hand, the ASEAN Charter still provided the principles of settling the dispute through dialogue, consultation, negotiation and mediation, which refers to soft law. Some scholars like Shaffer and Pollack support the legal and political science scholars’ view that the interaction between hard and soft law can be complementary. They state that these scholars contend that hard and soft law mechanisms can build upon each other in two

619See Chapter VIII of the ASEAN Charter.
primary ways: (1) non-binding soft law can lead the way to binding hard law, and (2) binding hard law can subsequently be elaborated through soft-law instruments. The author to some extent supports this theory and it seems to match with ASEAN’s characteristics. However, with regard to legal certainty and protection to parties, such as in trading and payment transactions arrangement, the author prefers using hard law instead of a combination of the two.

Looking at the European Union, they also have some experiences using soft and hard law for its policy. Some scholars investigated the EU Fiscal policy coordination as an example in which the EU use both soft and hard law together to achieve maximum effectiveness, known as hybridity. This system has been tried to face the difficulty and potentially contradictory imperatives, but has failed to work as originally hoped because the soft law could not prevent this development and the Union’s inability to deploy the hard law sanctions has forced the EU to reconsider the original design.

The author argues that learning from the EU experience, ASEAN should be wise and aware that using soft law or hybrid law is not recommended. The hard law is one that provides legal certainty. The author observes that the Charter should be reformed by restructuring the functions of the ASEAN policies and bodies to provide more support for the necessity of ASEAN to face the AEC 2015, especially in providing legal certainty in case of a legal dispute settlement. Woon concludes that in relation to this, is the creation of a formal system for the peaceful settlement of disputes, and the cornerstone of the dispute settlement regime of ASEAN is the Charter.

1.3.3 The Role of Public and Private International Law and Regional judgment for ASEAN-ARTS

Since the establishment of the ASEAN-ARTS is related to the interactions among the legal systems and foreign elements, private international law will be used to address legal problems. It will deal with problems that may arise when transactions contain or involve a foreign element. Then the conflict of law rules and the rule of international jurisdiction will be used to ensure obedience to criterion set by an authority of the community and to safeguard their interests by averting any option to laws that may defeat community goals.

621 ibid.
623 ibid.
It is obvious that in an economic integration there is an economic community of a region that cannot merely function based on a substantive rule. There will be a need for rules and procedures to deal with issues, which may arise in cross-border transactions. For this purpose, the ASEAN Community should develop rules in order to determine the applicable law and to determine which court has jurisdiction. Prof. M.H. ten Wolde and Henckel observe that private international law (PIL) seeks to regulate problems arising from the confluence of (national) legal systems. The efficient and equitable regulation of the judicial matters, complicated by legal diversity, is the primary purpose of PIL.

To get a better understanding of the origins of PIL, the private international law emerged and existed as early as the fourth century B.C., when the Greek city-states came into their prime and trade was active in the eastern Mediterranean. Some scholars also claimed that PIL was invented as a mechanism for the reconciliation of higher-level natural law with the existence of diverse laws in different Italian city-states, and developed through its application to similar structural legal problems in various states, including France, the Netherlands, and Germany. Mills indicated that the early development of ideas of private international law was traced to with Roman law. It was around the time of the Italian renaissance, when there were international trade and commerce between European city-states and with the Middle East, which led to an increase in disputes with significant foreign elements. He noted that the first idea of private international law was probably the statutist approach which has two basic ideas, i.e. the idea of personal law, which is associated with individuals by virtue of their identity and the idea of local law, which is associated with a particular territory or region. By adopting a division between personal and territorial laws, the statutist approach followed and reflected the developing complexity of the political, social and economic order.

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626 Ibid.
630 Ibid. pp.28.
632 Ibid. pp.32. The idea of statutist approach was that each statute ‘naturally’ belongs to one of these two categories of laws. If a law is personal, it ‘attaches’ to the person and applies outside the territory of the statutory authority. If a law is local, it ‘attaches’ to the land and applies only within the territory of the statutory authority, but to all persons within that territory, pp.33.
633 Ibid.
The author observes that Europe has a big role in influencing other regions. European countries have lots of scholars who developed the rules of private international law with theories conflict of laws that may inspire other regions to adopt their concepts. Ten Wolde and Henckel affirmed that one of the greatest European scholars namely Friedrich Carl Von Savigny with his paradigm became the starting point for conflict of laws as we understand it today, which is to apply the law that has the closest connection.

Related to the ASEAN-ARTS initiative, it is known that the parties consist of the ASEAN Central Banks as operators, which represent their respective governments and participants of the system. In this regard, it is apparent that this initiative is not only related to the individual or company’s economic transactions but also to regional state relations. In other words, this would be the domain of public international law to address the National Central Banks despite the fact that there are also some issues of the private international law (PIL) to be addressed.

The author is inspired by Ten Wolde and Henckel’s statement related to PIL:

“Private international law is intended to ensure that such relationships are not handicapped by the differences existing between legal systems when legal disputes cross national borders. Decisional harmony, the creation of uniformity in determining the applicable law, and the certainty that it offers is seen by many as the ultimate purpose of the conflict of laws.”

Uniformity or a unified system of choice of law, according to Baarsma, offers a number of advantages over the situation in which every national state has its own system. Moreover, she also emphasizes that unification of the choice of law would grant better protection to the legitimate expectations of the parties. It is clear that PIL provides a better solution for conflict of law between parties from different states.

Additionally, public international law also relates to this cross-border payment system. It appears to the author that there is a need to use a right combination of

634 M.H. ten Wolde and K.C. Henckel, Op.cit., pp.10. There are also other European scholars and jurists who were famous in developing the private international law such as Hugo Grotius, Ulrik Huber, Bartolus and Pasquale Stanislao Mancini.
635 It means that, the relevant law which governs the case is the law which has the closest connection, with the case, connecting factors, such as habitual residence/domicile of parties, places of business/incorporation, place where the contract is made, place where the performance is to occur, language of the contract written, currency they use, and flag of the ship.
636 Ibid., pp.12.
638 Ibid., pp.96.
public and private international law for implementing the ASEAN-ARTS initiative. The author agrees with Mills’ statement that:

“Private international rules, although formally part of national law, constitute a type of distributed network of international ordering. This order both reflects and replicates underlying international norms, which are also reflected in rules of public international law. Public international law rules define the conceptual framework and terrain within which private international law seeks to achieve its own specialized international function: the reduction of conflict between regulatory systems in private disputes. Within this framework, differences in private international law rules correspond to competing ideas combining international and national influences.”

The central bank itself in this case will play a role as two personifications: First, as an agent of the state, and second, as a legal entity. In the first one, the central banks play a role in a public international law, representing their respective governments in making regulations and in the second one, the central banks play a role in private international law as one of the parties to be ruled, as an entity, and as a participant.

Public international law is needed and is particularly important because there will be clauses on rights and obligations that must be transposed either by those legislatures or by executive measures into domestic law. Gerrit Betlem states that in public international law one cannot find a comparable authoritative formulation of the principle that, under public international law, courts should construe their domestic law in conformity with international law. It means that the community law should be obeyed by the domestic or national law.

In relation to private international law, the parties should have a choice of the applicable law when disputes arise among them. If the parties have chosen the applicable law for implementing this initiative, it must be applied and be complied with as the governing law of the parties. The chosen law must be effective which means it should be recognized by the national law of the parties and should not infringe the public policy or mandatory rules of the parties.

Furthermore, the regional judgments should be enforced by the judicial national courts of the respective member states. Judgments from other ASEAN member

639 Alex Mills, Opcit., pp.24.
641 For example see the EU PIL law on Art.3 and Art 4.1(b) of Regulation (EC) No.593/2008 of The European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligation (Rome I).
642 The author use a term of regional judgment means a decision or judgment made by the regional/community authority which is appointed by the community of its region.
states are not always recognized and cannot always be executed in the other member states. These are the challenges for ASEAN member states. Thus, the respective national jurisdictions need legislation that provides them the ability to enforce a regional judgment from the ASEAN country. It is necessary to have the rules governing jurisdiction and recognition and as well as enforcement of judgment which are governed by the community legal instrument which are binding and directly applicable.

In this case, the author suggests that there should be a judicial cooperation and dissemination in advance between the community and the respective national court, and this should also be examined and assessed by the member states of community periodically to ensure all the national courts are ready to apply the dispute settlement mechanism of the ASEAN-ARTS. The ASEAN member states also need to reform their respective national legislation in order to enable the national courts to enforce the regional judgment which are not recognized under their law, so it will not be subjected to varying national laws, which might result in different effects of regional judgment. With this reform it is expected that they will have the same application and interpretation of law, so that the national courts may not refuse to enforce regional judgment.

The description above demonstrates the importance of the public and private international law as well as the enforcement of regional judgment issues for ASEAN. It also demonstrates that the effectiveness of the private international law will lead to the achievement of the community purposes. In other words, the private international law plays a key role in fostering economic integration by providing solutions for dispute settlements in economic region. The author also concludes that the central banks of each member state should play a bigger role in coordinating the parties involved for this initiative not only at the domestic level but also at the regional level.

1.3.4 Legal Approach for The ASEAN-ARTS Initiative from International Standards

The implementation of the ASEAN-ARTS will work efficiently with the application of international standards, like adopting international policy guidance by the BIS and other related international institutions, like the World Bank and the IMF. Since every member state is part of the principles/rules of those mentioned institutions, the implementation of this initiative should be going smoothly.

The first one of the Core Principles for Systemically Important Payment System (CP-SIPS) states “The System should have a well-founded legal basis under all relevant

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jurisdictions.” 644 ASEAN in this case should have unified basic rules applicable to payment system for all member countries. By using one of these standards or creating its own model law on payment and settlement systems as a guideline for members, it will be helpful to make sure that the system developed to implement the ASEAN-ARTS are expected to be parallel and compatible with the developments in other ASEAN countries. It is known that the RTGS systems of the EU also comply with the international standards, so ASEAN may refer to the guidelines, specifications and user requirements of TARGET as a benchmark for establishing and developing the ASEAN-ARTS.

Another very inspiring example is the development of a regional payment system in Central America, known as Sistema de Interconexión de Pagos de Centroamérica y República Dominicana (the SIP). 645 The SIP have created a treaty as an umbrella for its regionalized payment system. The SIP also has model of laws such as finality of payments, and irrevocability of payment orders as its instrument of law. 646

Besides the international standards, there are also contractual agreements and other arrangements which are used in relation to the counterparties that involved in this system. 647

As a result in relation to this initiative, the author proposes to use a treaty for the ASEAN-ARTS initiative. A treaty will take into account the smooth implementation of such initiative, not only in the region but also in other countries outside of the region to show that ASEAN is emphasizing a rule of law basis and to show that this is a serious commitment of ASEAN as a first step by having a structured legal instruments of an integrated payment system to face the AEC 2015. This is going to be a special task for all ASEAN Central Bank Governors and the WC-PSS with the support of the ASEAN Secretariat and the ASEAN Financial Minister Committee to propose to the ASEAN Leaders a formulation of a Treaty on “The Establishing and

644See chapter 1 sub Chapter 2.3. on Core Principles for Systemically Important Payment Systems (CPSIPS-RTGS).
646Ibid. The author will not elaborate on the experience of Central America’s countries, but expects that this example will be explored further in future research.
647One of the contractual issues is related to communication network provider like SWIFT.
Implementation of the ASEAN-ARTS Initiative” to support the economic and financial market integration in ASEAN to Face the AEC 2015.\textsuperscript{648}

Why a treaty? Because a treaty will provide legal certainty and it is going to be a legal umbrella and formal agreement that will legally bind the ASEAN member countries, defining the objectives, tasks, rules, rights and obligations of introducing a policy area of cooperation. The author also would like to remind that this is also to simplify and homogenize the re-use of the standard term “treaty” which has been used the first time on February 24, 1976 i.e. Treaty of Amity and Cooperation (TAC). This will be consecutively followed by lower level authorities, such as the ASEAN Governors Central Bank, to make more detailed regulations covering all the rules and procedures of the game including the governing law and transposition clauses. The commitment of the ASEAN Leaders by a treaty becomes a powerful legal decree and serves as a legal umbrella for the next law-making process at the lower level. Furthermore, the functional bodies can adopt legislation at the domestic level, which should interpret the domestic law in conformity with this treaty.

Since the interlinking system of the ASEAN-ARTS is done through “interface”\textsuperscript{649} among the ASEAN National RTGS of National Central Banks, the author suggests that a bilateral agreement among the ASEAN National Central Banks will be ideal for them.\textsuperscript{650} The author prefers the use of bilateral agreements among the NCB and between NCB and participants, because: first, the NCB should open an account in the respective NCB. Secondly, the RTGS system is also based on the contract between the operator and the participants, because the participants also should open an account in their respective NCB.\textsuperscript{651}

To compose the agreement and related arrangements, ASEAN would need a working committee/group, which will be based on shared (legal, technical and operational) agreements between National Central Banks.\textsuperscript{652} Such agreements will consist of more detailed aspects i.e. general description of ASEAN-ARTS, the rights and obligations of the parties, the access criteria, liquidity, finality, intraday credit, compensation, liability, governing law and jurisdiction.

The author concludes that in essence, the key points to implement this initiative smoothly is coordination and cooperation, by, firstly, putting this initiative into a part

\textsuperscript{648}The idea of using a Treaty for ASEAN-ARTS initiative, is inspired by the method of the EU in creating TARGET based on the Treaty of establishing the European Community (TEC) which was amended by TFEU.

\textsuperscript{649}Interface is a design of system that to allow an access so that can send and receive data for transaction. The model of design itself will be discussed by the working group of ASEAN Central Banks.

\textsuperscript{650}Myanmar has not used an RTGS yet.

\textsuperscript{651}The selection of using of bilateral agreement is also to simplify when one of the participants wants to quit the system, then it is only related to the bilateral agreement between the operator and such participant.

\textsuperscript{652}This working group/committee will be required not only in the period of establishing this initiative but also during the implementation and development in the future.
of the ASEAN program, initiated by all Governor Central Banks via WC-PSS. Secondly, by having a political will and a full commitment from the Leaders of the ASEAN member states and their staff, including the ASEAN member states Governors of Central Banks, to create a treaty for establishing and implementing such policy/project and then, certainly followed by the respective member states adopting it into a national law. This is important and necessary, because it will involve the national bodies/institutions of respective members, not only the executive body but also the legislative body and judicial body, including private entities like banks and related financial companies. Lastly, there will be a dissemination and education to all the elements in all respective member states, so that they will be aware of such initiative.

1.3.5 Governing Law: Choice of Law for the ASEAN-ARTS – The Proposal

The ASEAN-ARTS is a system, which will be performed by all the ASEAN member states central bank by using their national RTGS. The characteristic of this cross-border transaction is a fund transfer of money, which takes place from one bank to another on a "real time" and on "gross" basis. Since this system is used for cross-border transaction, basically the parties are from different legal systems. The RTGS itself will be a highly secured credit transfer in the central bank money, since the system is considered as CP-SIPS.\(^{653}\) It can be assumed that there is no credit risk and settlement risk\(^ {654}\) unless there is insufficient fund, or the system defaults, and make the transfer delayed. In this system, the payer must have sufficient funds in his/her bank before such transaction starts and the system must be reliable and safe.

Commonly, a dispute may arise when the money is not transferred and received into the payee’s account or is delayed. This happens when the system is not working (due to technical malfunction) or if there is no sufficient fund. In this case, the payee is the party who suffers loss or damage.\(^ {655}\)

The ASEAN-ARTS system mainly has a public character\(^ {656}\), but to some degree, it is of a contractual nature.\(^ {657}\) Thus, there is a principle of the freedom to contract, so that

\(^{653}\)The ASEAN-ARTS should be complied with the CP-SIPS and PFMI.

\(^{654}\)Based on Bank of England, under the RTGS model, this settlement risk does not occur: all payments are settled individually and on a gross basis, so there is no scope for unintended credit exposures between banks to build up within the settlement process. Receiving banks can credit customer accounts or use incoming funds to pay other banks in the certain knowledge that settlement of each payment has already occurred. See “Bank of England’s Real-Time Gross Settlement Infrastructure”, Quarterly Bulletin 2012, Q3, Op cit.

\(^{655}\)In the case of technical malfunction, the payer may also has rights for a compensation. See, for an example, the TARGET2 Compensation Scheme, see further the ECB, “Information Guide for TARGET2 Users”, Op cit.

\(^{656}\)Public character means the public facilities which is provided by the government (central bank) that work to facilitate and provide for the public.

\(^{657}\)The contracts here i.e. the contract between the central bank with participants in relation with using the RTGS system’s equipment and the contract between participant with its customer who decides to use such system to do transaction.
the arrangement in the contract becomes the rule of the parties involved that must be complied with. However this contract has a special character and is separated and therefore differs from common commercial contracts because this is a specific transaction (fund transfer), which runs on a specific system. Moreover, basically, this system will be created, regulated, and operated among the ASEAN central banks representing the respective governments. So this is what the author calls an interconnection between the public and private international law (public-private relationship). The general rule is not so complicated as other rules of law, because this payment transaction will be final and irrevocable, and completed in seconds or minutes. Usually the cross-border transfer by commercial bank is T+1 or more, especially via correspondent banks. By implementing this ASEAN-ARTS the transaction will be concluded in seconds or minutes, not days. So that is why the author proposes this RTGS cross-border system to become a priority project to support and answer the need for an integrated payment system for achieving the objectives of AEC 2015.

The RTGS system itself, basically, has already been tested and has a very secured system with the risk mitigation. The interlinking among the NCBs RTGS will become the tasks of the working committee (WC-PSS). They have to sit and work together and share their knowledge and technical experiences to make it work properly.

Related to loss or damage in this system, it shall be limited to the party’s direct damage or loss i.e. the amount of the transaction in question and the loss of interest thereon. So, for such loss or damages, the harmed party needs to be protected. In this case, the author sees that the payee becomes the weak party and has the right of reward to get nominal damage and loss of interest when he/she does not receive the money in the same day. As described above, this cross-border payment system is one of many transmission of funds from a payer to a payee in another jurisdiction, therefore, the issues about how to determine the applicable law to govern the rights and obligation of the parties, especially for solving the breach of this kind of payment transaction is also very important to be discussed. The protection of the harmed party is the priority in this system. Related to legal risk, the FMI states that a

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658 Common commercial contracts such as trading contract, credit contract, insurance contract, etc.
659 There will be relationships between central banks, between central bank and its national banks and among national banks.
660 Refer to TARGET2, 100% of TARGET2 payments were processed in less than five minutes. See at http://www.ecb.europa.eu/paym/t2/html/index.en.html, last accessed on January 28, 2015.
system should identify and analyse potential conflict of law and develop rules and procedures to mitigate this risk. In that case, this system should govern the applicable law to facilitate a dispute that may arise and needs a choice of law principles approach due to conflict of laws, since this system is used in multiple jurisdictions.

In this case, the ASEAN Leaders and/or the Governor of Central Banks should be concerned about this particular aspect and should govern rules and procedures to resolve the problem of determining the applicable law. The unification of the law, especially the choice of law issues should be the priority for the ASEAN. Since this is going to be an international agreement, it will be wise to set forth such a clause in their agreement to evade the ambiguity in determining the applicable law, like the EU did. The author argues that this becomes a good first step and a good example for a wide-range of issues of dispute settlements in other regional commercial projects.

Additionally, the ASEAN member states are the member of CPSS and FMI of BIS. The members comply with the principles within their regulatory frameworks, at least for the systems that are deemed to be systemically important in order to manage the risk more effectively and efficiently. The ASEAN-ARTS is considered to be a Systemically Important Payment System (SIPS) and that is why it should comply with the CP-SIPS and PFMI from BIS. The BIS as an International Institutions has an international standard that can be a guideline for this initiative.

Furthermore, the BIS and the IMF could provide an expert team which examines and assesses the RTGS system in order to comply with the principles and prepare a public report as background documentation to the Financial Sector Assessment Program (FSAP) with the member country. These two institutions described above, beneficially support the member countries to get to full compliance to the CP-SIPS and the PFMI.

Besides the CP-SIPS and PFMI, ASEAN member states also may refer to the United Nations Commission on International Trade Law (UNCITRAL) model law as an option. This organization has produced numerous model laws and has successfully influenced countries to adopt these model laws and drive the national law to apply in line with these model laws. The ASEAN member states could also study and may adopt the UNCITRAL model law such as UNCITRAL Model Law on International Credit Transfers. This model law regulates the obligations of the parties.

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663 The EU provides such rule in Art.25 (ECB/2012/27).
665 Chapter II of UNCITRAL Model Law on International Credit Transfers. This chapter includes of obligations of senders, obligations of receiving bank, obligation of beneficiary’s bank, etc. Revocation could not be adopted since the payment transaction will be final and irrevocable.
consequences of failed, erroneous of delayed credit transfers, and completion of credit transfer. The UNCITRAL formulizes a harmonized rule on commercial transactions and provides technical assistance in law reform projects. Moreover, this organization also has a guideline governing the rights and obligations of the parties and also the liability for the losses due to a delay or an error of a credit transfer. This model legal rule was published to influence and persuade the development of national practices and might be drafted and adopted by the states. In addition, this model law was also created to unify and/or harmonize the law governing international trade or transactions that the states might wish to adopt to govern their international credit transfers. This also implies that the model law of UNCITRAL could create a unified or harmonized standard of protection for the losing parties and can be one of the options for ASEAN member states to adopt.

Related to the conflict of laws in the ASEAN-ARTS initiative, the issue of determining the law governing a transaction as well as the question of which forum decides a dispute arising out of any such transaction must be addressed only if there is an element of internationality or different jurisdictions. In relation to the applicable law, what is the most suitable approach to determine the law governing this payment transaction if there is conflict of laws? Prof. M.H. ten Wolde and Henckel distinguish three types of conflict rules i.e. (1) multilateral conflict rules; (2) unilateral conflict rules; and (3) independent of substantive conflict rules. Related to this system, it seems to the author that it is more connected to the approach of the multilateral conflict rules, which refer to the reference rule containing the connecting factor. Within PIL, the interpretation of rules of law and the creation of law concentrates on finding the right connecting factor, which in this case is the

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666 Chapter III of UNCITRAL Model Law on International Credit Transfers. This chapter includes of refund, correction of underpayment, restitution of overpayment, liabilities and exclusively of remedies.

667 Chapter IV of UNCITRAL Model Law on International Credit Transfers.


671 M.H. ten Wolde and K.C. Henckel, Op cit. pp.13. (1) Multilateral conflict rules see to the application of domestic law as well as to the application of foreign law. These rules refer the international legal relationship to either domestic law or foreign law. The international legal relationship is ‘brought home’ to a particular country and is subject to the law of that country (example is found in Article 4 of the Rome II Regulation); (2) Unilateral conflict rules (scope rules) only indicate when domestic law applies. These rules do not determine the application of foreign law or the geographical scope of foreign law. (an example is found in Article 6:247 of the Dutch Civil Code); (3) Independent of substantive conflict rules are not a reference rule (it does not refer to a particular law), but directly regulates a particular question of law; is a piece of united private law. (an example can be found in Article 23 of the Brussel I Regulation).
protection of the weaker party. This is then expressed in the reference rule to be utilized.\footnote{Ibid., pp.14.}

Prof. Sudargo stated that such concept, called “the Most Characteristic Connection” principle, is the best approach to be used to determine the applicable law for international contracts where the applicable law is the law closely connected or having the most significant relationship to the occasion.\footnote{Prof. Sudargo Gautama, “Hukum Perdata Internasional Indonesia”, Jilid III, Bag.2, Buku ke-8, PT. Alumni, 1998, pp.44.} He also emphasized that this approach also uses the term “centre of gravity” but in the ‘soft’ manner and is considered as the modern approach and followed by other scholars and jurisprudence of many countries.\footnote{Ibid., pp.32-33.} Furthermore, he stated that: \footnote{The original of his statements: “Jadi dalam melakukan pencarian ke arah titik taut yang paling karakteristik atau ‘typis’ atau ‘fungsional’ ini, bukan kita hanya melihat faktor tempat, tetapi juga kepada faktor sosiolegal.” \footnote{M.H. ten Wolde and K.C. Henckel, Op.cit. pp.24.}}

\begin{quote}
“in the exploring towards the most characteristic point link or the ‘types’ or ‘functional’, we do not only see the location factors, but also the sociological factors.”
\end{quote}

In the EU, the method of determining the applicable law is strongly connected to the basis for the legal dispute.\footnote{Ibid.} The law of the country where the legal relationship has its centre of gravity is to apply.\footnote{M.H. ten Wolde and K.C. Henckel, Op.cit. pp.24.} Additionally, the EU also has a regulation in the absence of choice of law, namely where the applicable law cannot be determined; the dispute shall be governed by the law of the country with which it is most closely connected.\footnote{M.H. ten Wolde and K.C. Henckel, Op.cit. pp.24.}

The author concludes that the most characteristic connection for ASEAN-ARTS is related to protect the weaker party who will incur the damage/loss if the transaction failed. This approach seems to be the best option for this system, since the EU also uses this approach for settling disputes for TARGET2.\footnote{Ibid.}

Furthermore, Sudargo Gautama recalled that this choice of law should not breach what is known as Public Order.\footnote{Prof. Sudargo Gautama, “Hukum Perdata Internasional Indonesia”, Jilid III, Bag.2, Buku ke-8, PT. Alumni, 1998, pp.44.} Any choice of law should not be transformed into an evasion of law (\textit{wetsontduiking}).\footnote{Ibid.} However, according to Sumampong, such choice of law should also be concerned to the other parties’ interests and/or public interests, but in the contract, the interests of the parties have a big influence in

\footnote{See Art.25 (ECB/2012/27).}

\footnote{Prof. Sudargo Gautama, “Hukum Perdata Internasional Indonesia”, Op.cit., pp.5.}
determining the applicable law. The author concludes that as long as the contract does not hamper or breach the public interests or public order, then it can be carried out as the law of the parties involved. In this case, the author does not see that this initiative will contradict public order or public policy.

It appears to the author that this approach is the most suitable to the ASEAN-ARTS system. Since the payee is the party who is economically aggrieved, the term of “the economically aggrieved connection” fits to be used for this system. So, when the money is not delivered to the payee account at a certain time, then the payee will economically suffer losses for not getting the benefit of the money at that time and becomes an aggrieved party. From the EU experience in governing the applicable law for TARGET, they also govern the disputes concerning payments between TARGET2 component systems by choosing the law of member state where the payee is located.


Once again, when the payment system has to cover different elements/nations, the legal issues arising will be difficult to resolve due to different law for each territorial authority. Each country feels that this issue falls under its sovereignty to solve the problems, and the following question will arise: which forum or court will take the case?

When discussing about the word of court, many scholars compare it to the alternative dispute settlement, which they think is a less time-consuming process and will cost less money. Erica Garay, in her official law firm’s website states that generally, parties choose alternative dispute resolution mechanism (arbitration) over litigation because arbitration is usually faster, more efficient and less expensive than litigating a dispute in court. Barbara Kate Repa, has also observed that arbitration is generally far less costly than proceeding through litigation because the process is faster and usually less complex than a court proceeding. Louise Elmes sees more advantages of using arbitration proceedings i.e. neutrality (impartiality factor), enforceability (award judgment), flexibility (agreed procedure) and confidentiality (regarded as private). Joachim Frick also adds that further advantages of

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683 Art.25 (3) ECB/2012/27.
arbitration includes the expertise of arbitrators, and the neutrality of procedures. The nationality of arbitrators, the applicable law, the venue and language, its privacy, simplification and speed, the facilitated enforcement of the awards, and the enhanced predictability are also the advantages of using the arbitration. 687

It seems to the author that litigation in court is not a proper instrument to solve problems related to payment systems dispute with a unique characteristic, especially like the RTGS system. This payment system needs fast solutions and confidentiality in resolving the disputes, using expert personnel in a more private setting, but still legally binding and resulting in a judgment enforceable in other jurisdictions/countries.

In this global economic era, when business transaction problems arise, the author argues that an alternative dispute resolution (ADR) is a good instrument for dispute resolution of commercial matters. ADR means any method of settling disputes aside from the courtroom. Love states that ADR has emerged as an alternative to court litigation that may offer a more efficient and less expensive avenue for resolving disputes. 688 Furthermore, she observed that according to data from the World Bank’s Doing Business project, the time required to enforce a contract (from the moment the plaintiff files the lawsuit until payment is made) ranges from about five months in Singapore and seven in New Zealand to more than four years in Guatemala, Afghanistan, and Suriname. 689 Moreover, she discovered that the cost ranges from less than 10 per cent of the contract value in Iceland, Luxembourg, and Norway to more than 100 per cent in countries such as Cambodia, Indonesia, and Sierra Leone. 690 In addition, she also concluded that ADR can resolve different types of disputes, not only commercial matters, but also other disputes such as between employees and management, between investors and the state or even between businesses and the government (such as tax disputes). 691

The author observes that out-of-courtroom resolution schemes are more attractive and suitable for businesses than litigation proceeding because these mechanisms are confidential so may not trouble their relationship, they are more cost-effective and less time-consuming for businesses than conventional litigation. However, Louise Elmes reminds us that although arbitration proceedings remain the most popular choice, it is worth to consider particular needs against the potential advantages and

689 Ibid.
690 Ibid.
691 Ibid.
disadvantages of both forums before taking a decision. The author agrees with her statement to put both forums into consideration. However, related to payment system, especially for cross-border payment transactions in RTGS, this does not apply, because it should be remembered that RTGS as a cross-border transaction mechanism is separated and different from commercial relationships. It is about the clearing and settlement mechanism, therefore it needs a specific dispute resolution mechanism, which provides particular expert personnel, neutrality, confidentiality and flexibility and moreover, can be enforced in other jurisdictions. The author prefers to say that it needs something like a “bank out-of-court”, a specific arbitration court which consists of members from each state as judges/arbitrators. Concerning these conditions, the out-of-courtroom resolution is a more proper instrument to use than court litigation.

There are two most major forms of ADR i.e. Mediation and Arbitration. Gavin Smith finds that mediation and arbitration are characteristically fitted for commercial disputes, because they provide a less public forum for dispute resolution and they have a great impact on the profitability and reputation of businesses.

Mediation, is a voluntary basis and uses a third party as a mediator who is also an expert in settling dispute and is impartial to both parties. The EU has a specific directive, defining mediation as:

“Mediation means a structured process, however named or referred to, whereby two or more parties to a dispute attempt by themselves, on a voluntary basis, to reach an agreement on the settlement of their dispute with the assistance of a mediator.”

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692 Louise Elmes, Op cit.
693 The author suggests that the mediators and the arbitrators are from the registered bankers who know the legal aspects.
694 The forum that the author proposes is the forum of out-of-court settlement which contains of banker experts who will be registered on a list to be appointed by the disputants as judges/decision makers of their disputes. The bankers and/or professionals on the list should be legal experts in handling the cases. This forum will be provided by ASEAN, specifically facilitating the participants to resolve a dispute settlement which arisen from ASEAN-ARTS.
695 The other ADR is negotiation and conciliation. Usually the parties are doing negotiation or conciliation as a first attempt before continuing to the mediation or arbitration. Conciliation or Negotiation means bringing two opposing sides together to reach a compromise or (new) agreement in an attempt to avoid taking a case to trial. These two instruments are voluntary basis and less structured than mediation or arbitration. Usually used for labor or family disputes. See further, at http://legal-dictionary.thefreedictionary.com, last accessed on January 28, 2015. The author is not elaborating further these mechanisms.
It seems to the author that mediation is not about winning or losing a settlement based on rights and obligations, but is rather about settling a dispute to result in a win-win solution for the parties involved. The function of the mediator is more about facilitating and guiding rather than making a decision.

Lukasz and Alejandro also make a good statement:698

“The main idea behind mediation projects is not only to provide alternatives to litigation but to modify the whole dispute resolution system, including litigation, to make it more suitable for the parties in commercial disputes.”

From the description above, the author can conclude that mediation is an alternative dispute settlement to reach a (new/amended) agreement for disputants. There is no decision by third party – the third party is only facilitating the process of settlement or merely assists them in reconditioning the settlement so both parties are comfortable with the revised agreement and then lets the parties try to construct a solution among them.

The other option is an arbitration as already mentioned above. It is also an interesting mechanism that people choose for settling a dispute. According to Clayton Utz, the definition of international commercial arbitration is:699

“a process by which parties from different states can have their disputes determined by an impartial tribunal appointed by a commonly agreed method.”

The outcome is binding and can be enforced in other countries as a result of an international law called the Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).700 Additionally, Gaurav states that this convention provides a simple and effective method of recognition and enforcement of foreign awards.701

Erman Rajaguguk states that arbitration is more favourable for businessmen than litigation due to various reasons, including:702

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700Ibid.
“1. publication of dispute is one of the things that disfavour for businessmen;
2. the legal system of a local court is unfamiliar to foreign counterpart;
   and also
3. there is a doubt to the capability of local court and/or a mistrust
   from foreign counterpart to the local court’s decision on cases
   which have foreign elements.”

Additionally, Huala Adolf stated that there are five reasons why businessmen prefer
to use the arbitration forum.703

“First, they do not have to follow the strict and rigid formalities; second, the arbitration
is relatively cheaper; third, the decision is more satisfying to them since they more believe to the arbitrators whom they
have chosen themselves with their expertise; fourth, the confidentiality
among the disputants is preserved; and fifth, from the commercial or
business perspective, this mechanism is considered as the perfect choice
for them, so that the disputants could still maintain their good
relationship.”

Furthermore, other scholars argue it is far easier to enforce arbitration awards across
national boundaries than judgments of national courts.704 T. Mulya Lubis and
Maurice also argue that ASEAN countries such as Indonesia, Singapore, Malaysia,
the Philippines and Thailand have systems allowing and enabling winning parties to
enforce arbitral awards in the same manner as judgments obtained in local courts,
subject to leave of those courts.705 Moreover, they also say that these countries are
members of the New York Convention, which provides that foreign awards obtained
in member states may be recognized and enforced locally, subject to the very limited
grounds recognized in the convention upon which a court may refuse enforcement.706
Furthermore, they also argue that a court may refuse enforcement for several reasons:
the arbitration agreement is invalid; a breach of due process; the award does not
comply with the terms of the arbitration agreement; irregularities in the selection of
arbitrators or the proceedings; enforcement is against public policy.707

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Finance LP in the vol.2, No.6 edition of the Bloomberg Law Reports-Asia Pacific, 2009. See also at:
705 Todung Mulya Lubis and Maurice Burke, “International Arbitration Developments in Republic of Indonesia”,
The Jakarta Post, 10 December 2004. Available at http://www.thejakartapost.com/news/2004/12/10/int039l-
arbitration-developments-ri.html, last accessed on January 28, 2015.
706 Ibid.
707 Ibid.
This New York Convention has its goal\textsuperscript{708} i.e.

"... that foreign and non-domestic arbitral awards will not be discriminated against and it obliges Parties to ensure such awards are recognized and generally capable of enforcement in their jurisdiction in the same way as domestic awards. An ancillary aim of the Convention is to require courts of Parties to give full effect to arbitration agreements by requiring courts to deny the parties access to court in contravention of their agreement to refer the matter to an arbitral tribunal."

In addition, Karl-Heinz Böckstiegel states: \textsuperscript{709}

"As far as public international law is concerned, for commercial arbitration, the only really relevant treaty is the New York Convention which ‘only’ deals with the recognition and enforcement of foreign arbitral awards, while the other traditional instruments play no major role today."

The author conclude that the New York Convention of International Arbitration Awards which has been ratified by 149 member countries,\textsuperscript{710} is providing an effective and efficient solution and moreover can be enforced, so that the member states which signed the Convention are required to fulfil the arbitral judgment in their respective state. On the other hand, it should be understood, that the local court may refuse the enforcement judgment due to reasons mentioned above. The author sees that this seems unfair for the party who has the right to execute the judgment. For the sake of fairness and in order to provide legal certainty, the judgment shall be executed in advance and should not be delayed; meanwhile, the request for cancellation of the judgment can be run simultaneously. Sutiarso also affirmed this with his opinion that in accordance with the legal certainty theory, a plea of examination of cancellation of the judgment process should not delay the execution of a final and binding arbitral award.\textsuperscript{711} In this case, the author observes that the role of arbitrator(s) is very important. They must be cautious and accountable in formulating the decision, so that the dictum of decision does not cause or give rise to new problems that may be refused by the court.


\textsuperscript{710}ASEAN member countries are also the members of the New York Convention 1958. See at: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html, last accessed on January 28, 2015.

\textsuperscript{711}Cicut Sutiarso, "Pelaksanaan Putusan Arbitrase dalam Sengketa Bisnis", Yayasan Pustaka Obor Indonesia, Jakarta, 2011, pp.221.
Additionally, unlike a judicial process, arbitration is conducted by impartial arbitrators who are appointed by the disputants based on standards that suit their special needs and lies on the characteristic of the contract. Arbitration usually consists of either one arbitrator or mostly a tribunal of three arbitrators who have expertise and are impartial to the disputes and have been empowered to make decisions. The judgments can be enforced due to the New York Convention.

There is also another model law such as the UNCITRAL model law on International Commercial Arbitration as an option. This option provides a model law acceptable to states with different legal, social and economic systems, contributing to the development of harmonious international economic relations. This model law, like other laws related to arbitration, has the rule to restrict the power of the court to intervene. This model law also has a binding judgment, recognized and enforced by the competent court. It covers all stages of the arbitral process from the arbitration agreement to the recognition and enforcement of the arbitral award and reflects a worldwide consensus on the principles and important issues of international arbitration practice. It is acceptable to states of all regions and the different legal or economic systems of the world. The author observes that this model law may also be adopted in ASEAN.

From the description above, the author outlines the differences of mediation, arbitration and litigation. in table 5 below

<table>
<thead>
<tr>
<th>No.</th>
<th>Features/ Characteristics</th>
<th>Mediation</th>
<th>Arbitration</th>
<th>Litigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Type of decision/ outcome</td>
<td>Non-final/consensual</td>
<td>Final and Binding</td>
<td>Final and Binding</td>
</tr>
<tr>
<td>2.</td>
<td>Selection of referee(s)</td>
<td>By parties</td>
<td>By parties</td>
<td>By court</td>
</tr>
<tr>
<td>3.</td>
<td>Referee’s expertise</td>
<td>Specialized expertise</td>
<td>Specialized expertise</td>
<td>General expertise</td>
</tr>
<tr>
<td>4.</td>
<td>Cost</td>
<td>Less costly</td>
<td>Less costly</td>
<td>Costly</td>
</tr>
<tr>
<td>5.</td>
<td>Time-consuming</td>
<td>Less time</td>
<td>Less time</td>
<td>More time</td>
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<tr>
<td>6.</td>
<td>Confidentiality</td>
<td>Private</td>
<td>Private</td>
<td>Public</td>
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<tr>
<td>7.</td>
<td>Neutrality</td>
<td>Impartial</td>
<td>Impartial</td>
<td>Domestic Court</td>
</tr>
</tbody>
</table>

Table 5
The difference among Mediation, Arbitration and Litigation

712 To have a tribunal, generally both parties appoint one arbitrator or each party selects one arbitrator and then the selected arbitrators choose the third.
714 Ibid.
715 Article. 5 of UNCITRAL.
716 Article. 35 of UNCITRAL.
718 Ibid.
The table above shows that the arbitration is suitable for parties or businesses who prefer processes which result in a final and binding decision, is less-time consuming, suits with the characteristics of the contract/agreement, is impartial, offers privacy and is controlled by parties, and most of all, can be enforced in the other states. It is interesting to note that Hartley, argues that in certain situations at least, litigation in an efficient and impartial court is the favoured solution. However, since he does not explain in more detail why litigation is a favoured solution, the author argues that this would only be fit for certain cases, such as international loan agreements which he analyses in his book.

In addition, related to cross-border transaction concerns, Chen and Howes state that:

“When cross-border business transactions lead to cross-border controversies, arbitration before an international panel of arbitrators—as opposed to litigation in the courts of a particular country—is usually the contracting parties' dispute-resolution mechanism of choice.”

In this case, the author concludes that arbitration has become a distinguished dispute resolution mechanism for cross-border transaction problems. The author proposes that the arbitration is suitable for the ASEAN-ARTS initiative as well and can be a good choice as an alternative jurisdiction of competent mechanism for settling other related cross-border problems in ASEAN.

Why does ASEAN-ARTS need arbitration? Based on the characteristics of the ASEAN-ARTS we could assess why the mechanism of arbitration will be the best to resolve a particular problem.

The ASEAN-ARTS initiative is purposed to support the economic integration and enhance the financial market of ASEAN. In addition, the spirit of the ASEAN economic integration provides a legal certainty for the parties and a binding legal system, which could protect the customers. This spirit as a result, will become one of the objectives of the ASEAN member states to convince and attract the third parties to be involved in the ASEAN financial markets that ASEAN has the competence and

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721 Ibid., pp.6.

a structured legal framework for cross-border transactions. The ASEAN-ARTS itself is a system which has a specific characteristic namely to transfer money from one country to another or a fund transfer between different states and this system is about the settlement mechanism. If a problem arises in the system causing delay or cancellation of the transfer so that it cannot be settled and the beneficiary (the payee) does not receive the money, the harmed party must be protected and will need legal certainty for getting his/her rights. Thus, the need for legal certainty and legal protection for parties in the ASEAN-ARTS is in line with the objectives of economic integration and the objectives of AEC.

However, the ASEAN member states may combine the implementation of mediation and arbitration accordingly, depending on the problem. If the problem is not of substantial matter and is easy to solve, then they could implement mediation at the first stage. When we look at the EU, they have a mediation directive to resolve the commercial matters. In this directive, the mediation outcome is possible to be made enforceable by request to the court or other competent authority. The author utters that the mediation outcome is not automatically enforceable like arbitration unless by request to the court. The EU has also prepared for certain legal aspects of information society services, in particular electronic commerce, in the internal market, which governs out-of-court settlement. Related to the out-of-court settlement, European Commission also has a recommendation known as a Commission Recommendation on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes. In this journal, the Commission recommends to promote extrajudicial settlement dispute procedures such as mediation, conciliation or arbitration where this out-of-court instrument may be set up by public authorities, businesses/professionals in the legal sector, professional bodies or civil society organizations. The author observes that the EU’s concern is to provide a legal framework for the consumer in order to ensure legal certainty and consumer confidence, so that it must lay down a clear and general framework to cover certain legal aspects of electronic commerce in the internal market. In this case, ASEAN should also be concerned to prepare such regulations in order to provide a legal framework and legal certainty as well as consumer confidence in facing the free movement of goods and services in ASEAN.

723 It can be determined by the amount of money or another options accordance with the need of the parties.
725 Art 6 EC Directive 2008/52/EC.
727 No. 98/257/EC of 30 March 1998, OJ. L/ 115  17.4.1998
On the other hand, a conventional adjudicative mechanism according to the author’s opinion also could not resolve these disputes at its best, because even though the decision is legally binding, it is time-consuming and costly, not to mention that the judgment itself is less enforceable. Moreover, unlike ADR, in this mechanism everything is on the public record, which is opposite to the nature of this business of the ASEAN-ARTS, while ADR can remain confidential for public coverage where one of the business characteristics is maintaining long-term business relationships.

In order to smoothen the implementation of arbitration and/or mediation, the respective ASEAN NCBs should address at least three things. Firstly, it is best to have rules and procedures, like a code of conduct, to be taken into consideration as the main stage. Böckstiegel, who has experience as an arbitrator for many years, suggested to discuss as early as possible in the beginning, before the case to have what is called the "Rules of the Game" that should be applied for the procedure at hand.\footnote{Karl-Heinz Böckstiegel, "Party Autonomy and Case Management — Experiences and Suggestions of an Arbitrator", 11 Schieds (2013, no. 1) pp. 1-5, at http://www.arbitration-icc.org/media/1/13644850393080/bckstiegel_party_autonomy.pdf, last accessed on January 28, 2015.} Additionally, he has observed that in this situation, it is important to realize that there are differences in the legal culture of the parties and of the arbitrators, otherwise misunderstandings and conflicts in the management of the case are inevitable.\footnote{Ibid.} Firstly, transparency of rules and procedures of arbitration and/or mediation for this dispute settlement are required in order to solve problems on such specific matters. Secondly, there should be a list of registered arbitrators/mediators consisting of legal experts, who would be best from the expertise of the NCB and commercial banks, and/or from legal expert practitioners.\footnote{It is what the author calls as a “bank out-of-court”.} Thirdly, a dissemination and education for related bodies in respective ASEAN member states should be carried out periodically, in order to smoothen the enforcement of judgment.

For arbitration itself, there are two types of arbitration i.e. Institutional Arbitration and Ad hoc Arbitration. For ASEAN-ARTS, the author proposes that Ad hoc Arbitration is the best fit for settling the case. The Ad hoc method not only waives the administration cost but could also be tailor made with a specific design of a mechanism for the specific contract between the parties like ASEAN-ARTS, so that it will suit their particular needs. Many model clauses are recommended by institutions, such as model law by UNCITRAL and International Chambers of Commerce (ICC) Arbitration Rules. The first model provides an excellent and well-tested procedure for ad hoc arbitration.\footnote{Clayton Utz, Opcit, pp.6.}
2. **Key Issues Related to the ASEAN-ARTS Initiative**

In the development of the ASEAN-ARTS initiative, some issues might arise. The following key issues need to be addressed to ensure and enable smooth and safe running of the operation:\(^{733}\)

- **Organizational Structure**
  Like other establishments, to smooth the initiative, an appropriate organizational structure for implementing and operating ASEAN-ARTS is urgently required and the most basic foundation. Since this system is established on governmental basis among the ASEAN member states, of course the organizational structure will involve and consist of all the ASEAN member states with at least a need for legal and technical group contributing to the legal and technical issues. Related to legal issues, it needs to be established in the national law of each AMS in order to provide a legal judgment of dispute settlement that may arise among the ASEAN member states. It is shown in principle no. 1 of FMI and 10 CP-SIPS.

- **Standard Rules and Procedure**
  With regard to technical issues, this system should have security and operational procedures. It needs to have common and standard mechanisms for authentication, identification and authorization. It is also necessary to have data protection, especially since this system is going to be sharing data of transactions among the ASEAN member states, so it is more important and relevant to have provisions for legal protection and binding agreements.

- **The Access Criteria**
  This issue is regarding the participants, which is also important to be considered. Since this system will be implemented in regional countries with different types of participants, it will be prudent to make common participants criteria or standardization on who could enter and participate in this system. The access criteria must be equal among the ASEAN member states.

- **The Pricing Policy**
  The pricing also needs to be discussed among the ASEAN member states. Recently, they have different pricing for each cross-border transaction. This issue should be raised in order to have a uniform understanding of the pricing policy among the ASEAN member states.

\(^{733}\)These key issues are not elaborated in detail by the author but they are expected to stimulate further research.
- The Multi Currency

The ASEAN-ARTS initiative could be using US dollar, which it is commonly used for trade all over the world. But, since ASEAN wants to use their own local currencies/multi currencies for trade settlement, it would also be possible for the ASEAN-ARTS initiative to use the local currencies as well for cross-border transactions. In this case, the local/multicurrency risk issue should be taken into consideration. The author suggests that this issue be discussed not only among the central banks but also involving commercial banks and/or correspondence banks and other appropriate stakeholders such as academics to get a better solution in settling the currency issues for squaring the settlement; for example having a bilateral settlement mechanism among the members to reduce foreign exchange risks and to avoid a potential longer-term impact on market liquidity, or mitigating the exchange currency risks, for example by hedging against foreign exchange currency risks or by having an FX swap arrangement.

- The Intraday Credit and Cross-Border Collateral Arrangement

With regard to the intraday liquidity that is needed in cross-border transactions, the ASEAN member states should consider to have a cross-border collateral arrangement to support intraday and/or overnight credit. This arrangement should be taken into consideration to all member states.

- The Zero-Hour Rules, Finality Settlement Rules and Related Regulations

When a cross-border transaction in ASEAN-ARTS is going to be implemented, the issue of zero-hour rule and finality settlement should be taken into account and should be addressed in relevant legislation. Moreover, it should consider the amendment of bankruptcy and insolvency laws in respective members accordingly, to provide the legal certainty for finality settlement and to prevent the unwinding payment mechanism that may still be used in some ASEAN countries that would create systemic risks. Furthermore, related regulations, such as electronic commerce regulation, consumer protection regulation, payment systems regulation, are also important to take into account in order to support the

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735An FX swap agreement is a contract in which one party borrows one currency from, and simultaneously lends another to, the second party. Each party uses the repayment obligation to its counterparty as collateral and the amount of repayment is fixed at the FX forward rate as of the start of the contract. See at http://www.bis.org/publ/qtrpdf/r_qt0803z.htm, last accessed on January 28, 2015.

736The zero-hour rule is a provision in the insolvency law of some countries whereby the transactions conducted by an insolvent institution after midnight on the date the institution is declared insolvent are automatically ineffective by operation of law.

737Indonesia, for example, is still using the zero hour rule mechanism for payment system.
ASEAN-ARTS initiative. In this case, the author sees this not only as a task for central bank, but also for the government and its related ministries to provide contribution for creating and/or amending related regulations to implement regionalized cross-border transaction and to support the trade settlement as well as payment settlement system to fulfil the goal of AEC 2015. The author concludes that in the development and implementation of ASEAN-ARTS, there will a need for wide-ranging governance coordination and commitment.

- Mechanism of Dispute Resolution

This mechanism should be placed in prudent manner as well. Since ASEAN already has the Dispute Settlement Mechanism (DSM), with the current Protocol namely Protocol to the ASEAN Charter on Dispute Settlement Mechanisms (ACDSM), the question is, could the ACDSM deal with the resolution for an ASEAN-ARTS dispute? The author argues that it may be efficient and effective if it can be solved as a part in the ACDSM, but this should be discussed further among related officials to have some adjustment and arrangement. In this case, the payment system group and the legal group of ASEAN-ARTS should outline for AMS the legal procedures applicable to consumer disputes settlement and the out-of-court procedures committed to such disputes. Each AMS should also have some expertise on this mechanism to be appointed as an arbiter or mediator.738

- Collaborative Oversight of ASEAN-ARTS

Related to creating an integrated payment system, collaborative oversight payment systems engagements need to be taken into consideration by the ASEAN members, besides the oversight of respective domestic payment system. The scope of oversight may come from the coordination of sharing information, cross-border crisis management739 and Business Continuity Oversight.740

- Holiday Calendar and Operating Hour.

When this initiative is implemented, it is also crucial to determine together the holiday calendar or the closing day for the ASEAN-ARTS activities in order to have the same closing day for all of the ASEAN member states who participate in

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738This has already been discussed in the previous sub chapter.
739BIS in its report realizes that the global financial crisis which began in August 2007 illustrates the importance of effective cross-border crisis management for the complexity of international financial transactions expanded at an unprecedented pace in the years preceding the crisis, while the tools and techniques for handling cross-border bank crisis resolution have not evolved at the same pace. See further on Report and Recommendations of the Cross-border Bank Resolution Group, *BIS, 2010*, at http://www.bis.org/publ/bcbs169.pdf, last accessed on January 28, 2015.
740ECB has a Business Continuity Plan for Systematically Important Payment System (SIPS) in 2006 which is related to the resiliency of payment system infrastructure. For example, how to mitigate from terrorist attack or power outages. See further at https://www.ecb.europa.eu/pub/pdf/other/businesscontinuitiesips2006en.pdf, last accessed on January 28, 2015.
this initiative. The author realizes that each ASEAN member state has its own particular holidays, so this is also important to be considered. Furthermore, the ASEAN countries are in different time zones, so it should also be determined which time zone to use as a reference for implementing it.

- The Non-State Actors and the Former High Level Official

As mentioned above, parties outside the central banks also play a key role in implementing this system. This should be underlined during the consultation in order to establish and develop ASEAN-ARTS not limited to government bodies among the ASEAN member states, but also embracing appropriate stakeholders, comprising of businesses industry, public community, related industry associations, academic, technology specialists and former high level officials, known as Non-State Actors (NSA). The NSA plays a key role in supporting this initiative. The role of NSA has been demonstrated when Bank Indonesia was planning to establish and implement the BI-RTGS in 2000 which was fully supported by banking associations and academics. The banking association on behalf of the participants have even made the rules of play called the bye-law for BI-RTGS. Moreover, the role of former High-Level Officials, such as Mr. Susilo Bambang Yudhoyono, Mr. Mahathir Muhammad, Mr. Rodolfo Severino, Mr. Ong Keng Yong, Mr. Surin Pitsuwan, and Mr. Pushpanathan, is also very important and needs to be considered. They have had experiences in developing ASEAN and are therefore valuable resources to refer to for action and thoughtful contribution for attaining the AEC 2015.

- Others

Other relevant measures, such as technology requirements and specifications and also mitigation and/or back up system should be put in place in order to ensure the accuracy and integrity of data. These measures should comply with the FMI and CP-SIPS Principles.

3. Summary

From this chapter, the author concludes that ASEAN has defined the AEC blueprint and the ASEAN Central Bank Governors followed it up with more comprehensive and specific measures by creating the WC-PSS related to payment system cross-border transaction.

741 Bank Indonesia as a payment system authority allows them to have technical agreement for themselves and Bank Indonesia also acts as an advisor during the making process of the bye-law. This bye-law arrangement might be adopted for the ASEAN-ARTS initiative among the banking association of ASEAN member states. This is expected that the ASEAN banking association may create a self-regulatory organization for them in the future.
The author also concludes that the WC-PSS’s policy needs to be adjusted by putting the high value payment system cross-border transaction project (ASEAN-ARTS) as a priority; as such project would provide the infrastructure for regional settlement of trade, capital market and retail payments as well. The RTGS cross-border transactions provides lots of benefits and is more feasible, relevant and can be prioritized to implement in the near future compared to capital market and retail payment area.

In relation to the ASEAN-ARTS initiative, it needs a legal basis. A treaty is the best fit for such initiative, since it will embrace all instruments binding at regional law level. The ASEAN-ARTS initiative should also comply with the CP-SIPS and the FMI.

With regard to the dispute that may arise in implementing the ASEAN-ARTS initiative, ASEAN should have regulations that govern the choice of law and choice of forum for settling the dispute. Since the characteristic of such initiative is credit transfer, the governing law should be the law of the country where the payee is located, because this party is considered as a weaker party who is economically aggrieved and needs to be protected.

In connection to the forum for dispute settlement, ASEAN should facilitate and provide arbitration, which is a more efficient and less expensive option for resolving the dispute. Arbitration also provides a legal certainty because it results in a legally binding judgment, which is enforceable in other countries that have ratified the New York Convention of International Arbitration Awards.
CHAPTER 5
THE ROLE OF INDONESIA IN ASEAN AND IN PAYMENTS SYSTEM INTEGRATION: FACING THE AEC 2015

1. Introduction

ASEAN was established by five founding member countries, and Indonesia is one of the leading countries with a big influence in ASEAN. Besides a leading role in establishing ASEAN, Indonesia was also the founding members of the Non-Aligned Movement (NAM) in 1955 and this organization became an instrument for the third world countries to show resistance against the east and west bloc influence. Furthermore, NAM was created for freedom and de-colonialism. Since ASEAN was established in 1967, Indonesia has also taken a leading role for the development of ASEAN until now. Vice president Mohammad Hatta at that time was the first pioneer who put the Indonesian foreign policy foundation, known as “Free and Active” (bebas dan aktif). Donald Weatherbee explains that “bebas dan aktif” is not a policy or strategy. It is a quality of policy in the way it is formulated and carried out: with national interests being defined independently, then pragmatically promoting those interests. The next sub chapter will explore the role of Indonesia in ASEAN and payment system integration for supporting AEC 2015.

2. Indonesia’s Role in ASEAN

Since Soeharto rose as a leader in 1967, Indonesia has proven to be a significant regional influence and, as a result, played a global role by emphasizing the non-aligned movement and diminishing great power influence from the region. This can be seen in 1983, when Indonesia proposed the Southeast Asian Nuclear Weapons Free Zone (SEANWFZ), but due to the unfavourable political environment in the region at the time, this proposal was only kept on the table. However, after a decade of negotiating and drafting efforts by the ASEAN Working Group on a Zone of Peace, Freedom and Neutrality (ZOPFAN), the SEANWFZ

742 The Non-Aligned Movement was founded and held its first conference (the Belgrade Conference) in 1961 under the leadership of Sukarno from Indonesia, Gamal Abdel Nasser from Egypt, Jawaharlal Nehru from India, Kwame Nkrumah from Ghana, and Josip Broz Tito from Yugoslavia. See further its evolution at: http://mea.gov.in/in-focus-article.htm?20349/History+and+Evolution+of+NonAligned+Movement, last accessed on January 28, 2015.

743 Anthony Smith, “Indonesia’s Role in ASEAN: The End of Leadership?”, *Contemporary Southeast Asia*, vol.21, no.2, August 1999, pp.239.

744 Donald E. Weatherbee, “Indonesia in ASEAN: Vision and Reality”, Institute of Southeast Asian Studies, 2013, pp.11.

745 Ibid.

746 ZOPFAN was signed in 1971 by the foreign minister of the ASEAN member states which they stated their determination to exert initially necessary efforts to secure the recognition of and respect for Southeast Asia as a
Treaty was finally signed by the heads of states/governments of all 10 regional states in Bangkok on 15 December 1995.\textsuperscript{747}

In the process of integration, the founding members of ASEAN (ASEAN 5) and new members, Brunei, Cambodia, Lao PDR, Myanmar, and Vietnam, better known as BCLMV, recognized the challenges they faced both inside and outside the region. Hadi Soesastro gives an example that Vietnam was not free from potential insurgencies, and Indonesia introduced a concept called national resilience to the region, and proposed that ASEAN strives to build its regional resilience.\textsuperscript{748} He emphasizes that Indonesia’s leadership in ASEAN has been mainly in the political field but has not exercised economic leadership.\textsuperscript{749} In addition, Hadi also implies that Indonesia was known as “Mr. No” due to its tendency to say no to various economic integration plans at that time, until suddenly it changed its policy and became “Mr. Go” when agreeing to go ahead with AFTA 1992.\textsuperscript{750} It seems to the author that since then, Indonesia became an active leader, not only in politics but also in economics and even social cultural area.

Indonesia, during President Soeharto’s administration, also played a leading role not only in ASEAN but also in Asia Pacific by hosting and chairing the Asia-Pacific Economic Cooperation (APEC) Bogor summit in 1994\textsuperscript{751} which was known for the Bogor Declaration or Bogor Goals where the APEC Leaders announced their shared commitment to achieve free and open trade and investment by 2010 for industrialized economies and 2020 for developing economies.\textsuperscript{752} This was then followed up in 1997 by an ASEAN vision 2020 which resolved

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\textsuperscript{748}Hadi Soesastro, “Indonesia’s Role in ASEAN and Its Impact on US-Indonesia Economic Relationship”, submitted at a Hearing of the Senate Foreign Relations Subcommittee on East Asia and the Pacific, U.S. Senate, September 15, 2005. See further at http://www.globalsecurity.org/military/library/congress/2005_hr/050915-soesastro.pdf, last accessed on January 28, 2015. It was begun in the early 1990s when the changed external environment brought a significant change in ASEAN economic cooperation. ASEAN leaders agreed to pursue regional economic integration through the ASEAN Free Trade Area (AFTA). Indonesia’s agreement was critical at that time, but Thailand’s diplomatic efforts made that possible to persuade Indonesia to say “Go” for AFTA.

\textsuperscript{749}Ibid.

\textsuperscript{750}Ibid.

\textsuperscript{751}See further at http://www.apec.org/Meeting-Papers/Leaders-Declarations/1994/1994_aelm.aspx, last accessed on August 5, 2014. APEC has 21 members. The word ‘economies’ is used to describe APEC members because the APEC cooperative process is predominantly concerned with trade and economic issues, with members engaging with one another as economic entities. See at http://www.apec.org/About-Us/About-APEC/Member-Economies.aspx, last accessed on January 28, 2015.

to chart a new direction towards the year 2020 called “ASEAN 2020: Partnership in Dynamic Development” which will forge closer economic integration within ASEAN.\textsuperscript{753}

In July 1998, the Thailand Foreign Minister, Surin Pitsuwan, at the annual foreign minister meeting in Manila suggested that the “flexible engagement”\textsuperscript{754} be adopted, but Malaysia and the newer members opposed this suggestion.\textsuperscript{755} He proposed this idea because the crisis in 1997 has given ASEAN the motivation to change and respond to new challenges by proposing an idea called flexible engagement to encourage ASEAN to play a more pro-active role on issues that would potentially affect the region as a whole. Only the Philippines, which was hosting the meeting, gave strong endorsement to Pitsuwan’s proposal, but other ASEAN members were lying low, adopting a wait and see attitude.\textsuperscript{756} Even in the next ASEAN meeting, Thailand was being accused as carrying a western agenda, namely the US foreign policy objectives.\textsuperscript{757} Finally, but certainly not less importantly, several ASEAN governments objected to the adoption of a flexible engagement as a corporate policy for fear that its practice could undermine regime security.\textsuperscript{758}

The author observes and admits that this flexible engagement proposal is indeed an excellent idea to support the objective of AEC 2015, but it can be understood that in that era, it is also a very sensitive issue because the ASEAN leaders seldom talked openly. They preferred talking in door-to-door meeting as opposed to having an open session.\textsuperscript{759}

\textsuperscript{754}Dr. Surin explained in his speech at the Foreign Correspondents Club of Thailand 11 August 1998. He explained that “Flexible Engagement” is meant to encourage ASEAN to play a more pro-active role on issues that have the potential to affect the region as a whole, whether those issues are international, regional or domestic. For example, if a dialogue partner pursues economic policies that ASEAN perceives as detrimental to its interests, it should be within its rights to call for changes in that policy, as it has been doing with Japan. Or if a certain member country complicates ASEAN’s relations with its dialogue partners, ASEAN should similarly have the right to consult with the country concerned on how to resolve the situation in a manner satisfactory to all. See also: Jurgen Haacke, “The Concept of Flexible Engagement and the Practice of Enhanced Interaction: Intramural Challenges to the ‘ASEAN Way’”, The Pacific Review, vol.12, no.4, 1999, pp.583. Flexible engagement involves publicly commenting on and collectively discussing fellow members’ domestic policies when these have either regional implications or adversely affect the disposition of other ASEAN members.
\textsuperscript{757}Ibid. After suggesting the idea of “Flexible Engagement”, in the next ASEAN meeting there have been thick accusations flying around the region that Thailand is carrying out a western agenda which is trying to echo the US’ foreign policy objectives. See also: the Irrawaddy at http://www2.irrawaddy.org/article.php?art_id=1166, last accessed on January 28, 2015.
\textsuperscript{759}ASEAN Leaders prefer talking bilaterally or tour diplomacy with other members to get supporting of a proposal or to solve an issue.
After Soeharto’s regime ended in 1998, Indonesia had a few changes of presidency until 2004. There were uncertainties in Indonesia’s domestic politics and economics. However, since Susilo Bambang Yudhoyono (SBY) took office as president in 2004 and especially in the second term, his government gave full attention to Indonesia’s role in ASEAN as the organization trudged the road to community. Zhida sees that since SBY’s administration, Indonesia has gradually emerged from the shadows of the collapse of Soeharto’s regime, as well as the economic and financial crisis. Zhida further explains the four areas of SBY’s platform, known as “confidence” diplomacy. The author summarizes her description as follows.

1. Strengthening its role in ASEAN affairs by actively leading the building of an Economic, Security, Social and Cultural Community by 2020, which was approved in the 9th ASEAN Summit in October 2003. In November 2007, Indonesia played a key role at the 13th ASEAN Summit and the ASEAN Leaders approved the ASEAN Charter, which clearly defines the strategic objectives of the ASEAN Community, and adopted the AEC Blueprint, which will translate ASEAN into a single, unified market. Secondly, Indonesia is enhancing relations with neighbouring countries by settling disputes with Malaysia on territorial issues in the Sulawesi Sea and with Singapore on maritime boundary line. Thirdly, Indonesia has helped mediate internal conflicts within ASEAN by mediating a boundary dispute between Thailand and Cambodia. Lastly, Indonesia is playing a constructive role in the South China Sea issue by pushing the China-ASEAN Foreign Minister Meeting in July 2011 to reach consensus on the guidelines to implement the Declaration on the Conduct of Parties in South China Sea (DOC).

2. Enhancing relations with great powers by signing a joint statement with the visiting Chinese president Hu Jintao in 2005, declaring that the two countries would establish a strategic partnership. In the economic field, bilateral trade volume has witnessed an annual growth rate of over 10%, with the bilateral trade value in 2011 surpassing USD 60 billion. China is Indonesia’s largest source of imports, except oil and gas products, and its second largest export market and trading partner. China takes an active role in infrastructure construction in Indonesia, and it has increased its investment in Indonesia. Moreover, the two

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761 During such period, there were East Timor’s separation, Aceh War, ethnic violence, the breakdown of law and order and the financial crisis.
764 Ibid. Summarizing the four platform of Zhida’s.
countries conducted close cooperation in advancing the China-ASEAN relations and in addressing the international financial crisis.

Besides China, Indonesia is also conducting international relations with U.S. by fighting against terror after the 9/11 tragedy and signing the comprehensive partnership agreement during President Obama’s visit to Indonesia, consolidating cooperation in the areas of economy, trade, education, military, climate change and democratization in 2010. India also became part of Indonesia’s diplomacy approach by signing the joint declaration on establishing an Indonesian-Indian strategic partnership with Indian Prime Minister Manmohan Singh in 2005.

Indonesia’s government under Yudhoyono administration has also established partnerships with Australia, the United Kingdom, Japan, France and Germany. The country’s great power diplomacy has gained more flexibility for Indonesian diplomacy, providing more opportunities for Indonesia to play a bigger role on the international stage.

3. Carrying out multilateral diplomacy. Indonesia has regained confidence on the international stage and is engaging actively in multilateral diplomacy as a result of the enhancement of its comprehensive strength, by becoming the sole ASEAN member and actively representing developing countries in the G20.  

Indonesia is taking an active part in the global governance and is playing a positive role in climate change, sustainable development, disaster relief, peacekeeping and other major international issues. Indonesia wishes to play a leadership role in the global effort to address climate change. President Yudhoyono urged more “synergic action” to best implement the concept of “common but differentiated responsibilities” in addressing climate change. Indonesia is the most vulnerable country to tsunamis, earthquakes, volcanic eruptions, floods, landslides, droughts and forest fires, and President Yudhoyono called on the international community to strengthen cooperation on disaster mitigation and relief. Yudhoyono also pushed forward the establishment of an ASEAN Coordinating Centre for Humanitarian Assistance on Disaster Management, in order to coordinate the cooperation in disaster rescue.

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765 In the G20 London Summit and Pittsburg Summit held in 2009, Indonesia has played a key role when President Yudhoyono put forward a number of proposals, including reforming the existing international financial institutions, stressing the recovery of the global economic balance, raising the economic growth rate, improving the economic, trade and investment environment, and advancing sustainable economic development. He demanded that developed countries open up markets (especially the agricultural market) to developing countries, increase technological transfers and direct investment. At the same time, he also called for the developing countries to fight corruption, establish better government, and increase education input to create a favorable environment for overseas investment.
4. Shaping and promoting Indonesia’s national image of “democracy, pluralism and peace” is an important part in the building of Indonesia’s soft power influence, and it is regarded as Indonesia’s strategic interest.

Under the initiative of President Yudhoyono, the first Bali Democracy Forum was held in 2008\textsuperscript{766}, which was designed to transform ASEAN with democratic principles and provide useful experiences for other countries to learn from in their democratization process. The purpose of the forum is to share experiences and practices of democratic development, and to promote regional and international cooperation in the field of peace and democracy.

Indonesia has also actively participated in UN peacekeeping missions with the aim of building an image as a peacemaker in the world, by sending its troops to southern Lebanon and Congo. Indonesia therefore became the largest contributor in Southeast Asia to UN peacekeeping missions.

3. Indonesia’s Role in Payment System for Supporting AEC

As previously described in the beginning of this chapter, in April 2010, the ASEAN Central Bank Governors Meeting in Vietnam has decided to endorse the establishment of the Working Committee on Payment and Settlement System (WC-PSS) to coordinate the modernization of national payment and settlement systems to support regional financial integration. It aims to develop and harmonize the region’s financial infrastructure in par with international best practices to facilitate the free flow of goods, services, skilled labour, investment, and the freer flow of capital under the AEC.\textsuperscript{767} Bank Indonesia (BI)\textsuperscript{768} played a prominent and active role by hosting and chairing the informal meeting of the ASEAN 5 WC-PSS in Bali in May 2010\textsuperscript{769} followed by the first meeting of WC-PSS in Yogyakarta, Indonesia in June 2010.\textsuperscript{770} Indonesia has been actively leading this committee and together with other member states, forming five specific areas of payment and settlement systems to determine areas for future enhancement, development, and harmonization.\textsuperscript{771} The committee realizes that the ASEAN members are at different stages in the development of payment and

\textsuperscript{766} This forum was participated by all ASEAN member countries as well as other Asian, while the United States, Canada and other Western countries were invited to attend as observers.


\textsuperscript{768} Indonesia, represented by BI, has become a co-chair since 2010 until present, with the first chairman, Ronald Waas then continued by Boedi Armanto and currently by Rosmaya Hadi. Ronald Waas was replaced in 2012 due to his promotion as a Deputy Governor of BI. There are actually two co-chairs with the second chairman is from Bank of Thailand and now from Bank Negara Malaysia.

\textsuperscript{769} Op. cit., WC-PSS website.

\textsuperscript{770} Ibid.

\textsuperscript{771} See the WC-PSS website, at http://www.aseanwcpss.org/aseanwcpss/Documents/WCPSS\%20Studies\%20Executive\%20Summary.pdf, last accessed on January 28, 2015. See further in previous sub chapter on the Establishment of WC-PSS.
settlement system and thus would have different needs. To meet this condition, they have conducted standardization and also provided support to each other through capacity building or technical assistance for less developed payment system. To integrate the payment and settlement system for all the ASEAN members of course is a long-term achievement beyond 2015.

From the description above, the author observes that Indonesia has played a prominent role in ASEAN and is active in multilevel tasks to promote the essence of the ASEAN Community, especially AEC, as well as in developing payment system integration for facing the AEC. Pakpahan shares his opinion and sees that Indonesia’s position is strategically important because of its involvement in ASEAN, in the East Asia Summit (EAS) and the Group of 20 (G20). He emphasizes that Indonesia realizes that ASEAN is crucial in order to maintain a balance of power between the US, China, India and Russia within the EAS. The involvement of those countries would promote commercial and investment activities in this region.

The author concludes that Indonesia has indeed taken a significant role in the South East Asia region, even in the East Asia region and Asia Pacific not to mention the Asia Africa Forum (Non Aligned Movements), The Organization of the Petroleum Exporting Countries (OPEC), and even the G-20. It is because Indonesia is the world’s biggest archipelago country with lots of resources so that Indonesia can play a prominent role and have big influence among the ASEAN member states. It has been shown that Indonesia is the sole country in Southeast Asia to become a part of G20 countries and the sole ASEAN member in Southeast Asia to be one of the founding members of the Non Aligned Movement.

In the payment system area, Bank Indonesia has also played a key role in coordinating the ASEAN members to have a framework of integrating the payment system within the ASEAN member states to support the AEC 2015. Rosmaya Hadi from Bank Indonesia, in Jakarta Post said that BI has active discussions with its counterparts in developing a more integrated national payment system before having an integrated payment system within the ASEAN region. Furthermore, the Indonesian banking industry will have a new real-time

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gross settlement system (RTGS) in which bank customers can carry out multicurrency transactions on a real-time basis. Moreover, she also adds that the Indonesian central bank and its counterparts in five ASEAN members, including Malaysia, the Philippines, Singapore and Thailand, had agreed to prepare for an integrated payment system. So, Indonesia has also played a key role in integrating the payment system area. The author has great expectations that Bank Indonesia could also encourage the ASEAN members to support the initiative of ASEAN-ARTS, proposed by the author.

4. **Reforming the ASEAN Charter**

ASEAN has the ASEAN Charter, which stipulates the dispute settlement mechanism, but until now, the DSM is far from the hope to be utilized. The member states prefer settling through amicable settlement than push the dispute to judgment. The effectiveness of the dispute settlement of the Charter needs to be reviewed. As we can see, since the enactment of ASEAN Charter in December 2008 until now, the decisions resulting from disputes amongst the ASEAN member states (AMS) are ineffective and unsatisfactory. The principles of non-interference and consensus/negotiation as stated in the Charter seem to be an obstacle and discourage them in achieving its objectives. Hwee argues that the Charter also does not address the implementation deficit that ASEAN suffered because of its lack of institutional mechanisms to ensure or enforce compliance with decisions taken. Moreover, many agreements made, need an effective resolution when the dispute occurred and this will open greater number of dispute cases to be solved.

To make a single market work in the EU, the EU embarked on a comprehensive legislative program involving the adoption of hundreds of directives and regulations, significantly increasing the supranational power of the EU.

The author agrees with Hwee’s opinion that in order to create an effective and efficient single market, ASEAN should deepen its integration and commitment by making a comprehensive legislation for certainty and compliance and also strengthen the institutional body(s) to carry out the tasks. The history of the EU legislative activities is characterized by distinct events of enlarging and deepening its monetary integration into a European Union by reforming the treaty revisions of the past 20 years. It is also characterized by increasing the competencies of the EU across various policy fields and expanding qualified majority voting in the Council of Ministers, while also steadily increasing the influence of the European Parliament in the EU Legislative politics since the Single European Act in 1987 until the

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775 Ibid.
776 Yeo Lay Hwee, “From AFTA to ASEAN Economic Community – Is ASEAN Moving Towards EU-style Economic Integration?”, in Finn Laursen (ed.) “Comparative Regional Integration: Europe and Beyond”, *Ashgate Publishing Group*, 2010, pp.240.
777 Ibid.
Lisbon Treaty in 2009. De Haan argues that the Single European Act was a major step in the European economic integration process which aimed to complete the European Community’s internal market by removing all barriers to the free movement of capital, labour, goods and services among its member states. It was also influenced by Delors declaration in front of the European Parliament that “in 10 years 80 per cent of the legislation related to economics, maybe also to taxes and social affairs, will be of Community origin” which has been repeated on many occasions by himself and has also been widely quoted or paraphrased by scholars alike, reported and distorted by journalists, politicians and officials of the European Institutions.

The aim of the creation of the ASEAN Charter is to give a legal personality to ASEAN. This is a basic need of integration, not just mere co-operation. In the past, we understand that the reasons for the establishment of ASEAN in 1967 were political/security issues. Roberts in his opinion also argues that the modern state formations of Southeast Asia were primarily through colonialism. ASEAN countries were colonized by European and US powers. After World War II, they obtained their independence and autonomy in various ways. Since then, they needed cooperation amongst them to protect the region’s peace and stability by establishing the ASEAN Regional Forum (ARF). As the economic alliances emerged, the ASEAN economic cooperation did not want to be left behind by other regions, like the European Union. Furthermore, ASEAN in its ASEAN Vision 2020 had made a commitment i.e. free flow of goods, services, investment, capital and skilled labour. They needed to deepen the integration to compete in the global market. Suryadinata states that the final target of the ASEAN States must be integration instead of co-operation.

From the experiences of five years after the promulgation of the ASEAN Charter, we have seen that the ASEAN Charter has been weak in empowering the institutional and legal competence for obtaining its purposes. Although ASEAN has an ASEAN Charter governing the ASEAN human rights body and has adopted the ASEAN human rights declaration at the

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781 Christopher Roberts, *Op cit.*, pp. 34. ASEAN was created based on the existence of mutual interests and common objectives which were to overcome the mutual isolation left behind by colonialism and to build a geographic entity that was at peace and cooperating for common purposes. See further, Rodolfo C. Severino, “Asean Faces the Future”, *ASEAN Secretariat, Jakarta*, pp.275, at www.asean.org/archive/pdf/sgbook01.pdf, last accessed on January 28, 2015.

782 Indonesia was controlled by Dutch. Malaysia, Singapore, Brunei and Burma were ruled by British. The Philippine had granted its independence by US.

21st ASEAN Summit in Phnom Penh, Paul Gerber, considers it a flawed instrument. He notes that unlike a convention, this declaration is not legally binding, although it does carry moral weight and is often a precursor to a binding treaty, like the UDHR led to ICCPR and ICESCR. Nevertheless, the author sees that this Human Rights Declaration was a step forward, which may lead to the emergence of the convention.

To give more power to ASEAN in pursuing the AEC 2015, the Charter should be adjusted in order to strengthen the existing bodies by giving the authority to manage related programs and to provide more legal power to facilitate the economic integration within AMS. For the adjustment, the Leaders of the ASEAN member states have already anticipated this development by giving room to review the clauses of the Charter as stipulated in Article 50 which states “This Charter may be reviewed five years after its entry into force or as otherwise determined by the ASEAN Summit”. This article gives mandate to a review and to examine the effectiveness of the Charter for improving the institutional and legal framework to meet the needs of AMS in the future. The author argues that this is a good opportunity for the ASEAN Leaders to use such clause and review the Charter. The author observes that the lack of institutions becomes a serious issue for ASEAN to deepen the economic integration. On the other hand, since 2008, the global financial market and political atmosphere has changed dramatically. The countries outside of ASEAN, such as China, Japan, Korea, even the EU and the US are looking to ASEAN as a potential huge market. These changes of global economic conditions must be utilized by ASEAN, which needs several reforms and expansions to strengthen ASEAN’s institution for regionalism to carry out the implementation of all the initiatives they have taken, especially to attain the AEC 2015.

Despite some scholars’ pessimism on ASEAN reform, there are other scholars who still see its bright future. Shada Islam, for example, argues that the Charter, which governs the establishment of the Committee of Permanent Representatives (CPR) to ASEAN, is ‘an important step forward in enhancing the institutional capacity of ASEAN’. He also argues that Indonesia has the gravitas and institutional capacity to lead ASEAN into new areas, besides Malaysia, which will be the ASEAN chair in 2015. The author agrees with Shada and is also optimistic that ASEAN could reform in order to achieve the AEC commitments. It

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785 Ibid.
786 See further sub chapter on ASEAN Legal Instruments: Hard Law vs. Soft Law.
788 Ibid.
is shown that after the global crisis of 2008, ASEAN could recover very well. Related to the ASEAN’s survival of crisis, Mustapa Mohamed stated that:

“This is (the 2008 crisis) not the first time ASEAN is faced with a crisis. We recovered from 1998 crisis, then September 11 crisis that had an impact on many ASEAN member states. The 2008 crisis affected the stock market, the confidence, not the real economy. In the short term, we will find not much impact, but if it lasts longer, let’s say between three and six months, if the US cannot resolve its problems and Eurozone countries cannot find a way out of the debt crisis, then we may see some impacts on ASEAN economies. However, there are two reasons why I believe that we can mitigate the impact of the crisis. First, our economies are doing well. We see domestic consumption increasing in most ASEAN countries. Second, Asia is doing quite well. We have China, India, and Korea, these are major markets for ASEAN countries. They are not facing a crisis. We will survive."

From his statement, the author argues that ASEAN’s economic developments are doing well and ASEAN can still do business with the eastern countries, like China, India, Korea, and Japan which also have huge markets for ASEAN countries. The global economic and political environments have transformed extremely due to the global financial crisis in 2008.

The ASEAN countries are facing the challenges, both individually and collectively as a region, but they could survive because they have learnt from the first crisis in 1997. They worked closes together and brought the three North East Asian countries (China, Korea and Japan, known as ASEAN +3) that were not affected by the crisis into some finance cooperation in order to increase their economic growth. This cooperation was then followed by the Chiang Mai Initiative (CMI), which was established by the ASEAN Plus Three Finance Ministers Meeting (AFMM+3) in 2000. Since then, ASEAN has been declaring numerous projects, like the Initiative for ASEAN Integration (IAI), the ASEAN Free Trade Agreement (AFTA), the ASEAN Investment Agreement (AIA) and the ASEAN Comprehensive Investment Agreement (ACIA) to keep up with global developments.

Benny Teh points out that as these initiatives become more sophisticated, institutionalization beyond the state would be inevitable or else there will be further disparities and unevenness if left to the devices of individual states. He also suggests that

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789 The global financial crisis of 2008, commenced with the US subprime mortgage crisis and followed by the collapse of Lehman Brothers which caused a panic and financial turmoil in the US economy. The US economy crisis also triggered Europe’s sovereign debt crisis in 2010.
ASEAN has to reinvent itself by further rethinking and reconfiguring the norms of sovereignty and consensus decision-making to best support the complexities of institutionalism that is increasingly seen as inevitable in a growing ASEAN.  

The author concludes that it is a good moment for ASEAN to reform the ASEAN Charter by strengthening and enlarging the function of the ASEAN Secretariat and delegating more power to them to have a wider combination as an independent body with executive, legislative and judicative functions to administer the activities of ASEAN and also by increasing and improving its human resources. Of course, the author realizes that it needs more financial support and more quantity and quality of human resources to implement it. As Vikram Nehru states, ASEAN has formed a task force to bolster ASEAN Secretariat. Indonesia should urge the task force to be innovative and propose fundamental changes to make the secretariat capable of coordinating effectively across its many functions. Then it should urge fellow member states to back up the ASEAN Secretariat with additional funding.  

Furthermore, empowering the dispute settlement body is also relevant and should be taken into consideration, in order to provide legal certainty and trust as an organization. The dispute settlement mechanism should be broadened by another mechanism, which would be best suited for settling economic, social cultural and even political disputes. Alternative dispute resolution settlement mechanism could answer challenges in the future. This also needs more legal expertise input from the member states. For example, by implementing the ASEAN-ARTS initiative, the member states should have a list of experts willing and able to become mediator or arbiter to settle the disputes. The expertise may come from banks or other financial institutions or even from the NCB.  

Once again, this reform of Charter depends on the willingness and commitment of the ASEAN Leaders to make it happen. When we look at the EU, on the one hand, they have amended the treaties many times, with the current treaty, namely the Lisbon Treaty (The first official name for the Lisbon Treaty was the "Reform Treaty") They started with economic co-operation until they became an economic union. On the other hand, ASEAN’s economic integration will not be as deep as the EU’s. However, the development of Europeanization should become an inspiration for ASEAN to attain the ASEAN economic

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792 Ibid. See further on pp.86-90.  
794 From the ECSC Treaty (1951), the Euratom Treaty (1957), the Treaty of Rome or the EC Treaty (1958), the Maastricht Treaty or the EU Treaty (1992), the Amsterdam Treaty (1999), the Nice Treaty (2003), and the current treaty was the Lisbon Treaty (2009). The Lisbon Treaty amends the Maastricht Treaty (1993), which also is known as the Treaty on European Union, and the Treaty of Rome (1958), which also is known as the Treaty establishing the European Community (TEEC) and was renamed to the Treaty on the Functioning of the European Union (TFEU).  
integration. Since the EU has Europeanization, in the future why shouldn’t ASEAN have an “Aseanization” to some degrees by reforming the Charter?

Nevertheless, the author admits that ASEAN does not need to adopt all the EU has done, especially to create a union, which are far beyond of ASEAN’s mind right now, because creating this stage requires time and effort, and it is not an easy task for ASEAN at the present time. ASEAN should focus on the implementation of the AEC 2015.

5. Summary

From this chapter, the author concludes that Indonesia has made significant contributions to the development of ASEAN. Indonesia represents ASEAN and other developing countries by actively participating in G-20. Moreover, regarding the payment system, Bank Indonesia, on behalf of Indonesia, has also played a leading role in coordinating the payment systems project to promote more efficient cross-border payment services and ultimately the integration of systems in the region. Indonesia had a key role supporting the future AEC.
CHAPTER 6
CONCLUSION AND RECOMMENDATIONS

The final chapter of this dissertation will summarize the general conclusions of the issues, which have been discussed in detail in earlier chapters. The purpose of this dissertation is to provide a better understanding of the effect of globalization, the AEC 2015, the development of ASEAN, the background of the EU and the ECB with its TARGET, and finally, the background of ASEAN’s initiative on the implementation of an integrated RTGS (ASEAN-ARTS) in ASEAN to support the AEC’s objectives.

One of the AEC’s objectives which was stated in the AEC Blueprint is the enhancement of the financial resilience and competitiveness in the region, by having greater integration of the financial markets. To support a greater integration, tools will be needed to facilitate the economic integration. A resilient payment system is one of the tools that supports the integration of the financial market. ASEAN could learn from the EU and its famous TARGET, but it should be taken into account is that the political-economic entities of ASEAN and the EU have their own characteristics.

This dissertation describes the EU experience from the beginning of its establishment until further development of the TARGET. It also examines whether or not the EU’s approach can and should be adopted by ASEAN. It has been discussed and explored that the EU draws its policies by treaties and/or formal agreements, while ASEAN prefers using informality and loose arrangements. The EU has institutions and binding commitments, whereas ASEAN relies on personal relations among the leaders and on settling issues by consensus and by reaching common interests.\(^\text{796}\)

The author concluded that the EU and ASEAN which significantly differ from each other and that they have their own specific character. Therefore, it can be said that ASEAN cannot simply use or adopt literally the EU’s model in order to achieve its objectives. However, in certain aspects, the author is of the opinion that ASEAN may learn from the EU’s experience and methods in creating the TARGET system to some degree, like adopting its leaders’ willingness, commitment and legal structure. All these aspects should be taken into consideration in order to further strengthen and deepen the financial integration within the ASEAN countries.

With regard to the legal aspects, signing a binding agreement is one of the factors that provides legal certainty and also provides legal protection to the parties involved. According to Tom Tyler’s study on human’s behaviour, the relationship between legitimacy and

\(^{796}\)Rodolfo C. Severino, “Southeast ASIA In Search of an ASEAN Community”. Opcit., pp.11.
compliance was found to be linear and has a significant correlation. He concludes that the more binding or the higher the standard of the law, the more people obey and comply with such law. As an example, Severino observes that ASEAN has some arrangements that are technically binding, like the ASEAN Tourism Agreement of 2002 and other variety of framework agreements, but most of them need implementing agreements in order to be carried out, whereas only a few have been concluded or even negotiated. In this regard, the author observes that the roles and commitments of the leaders on the legal aspects turn out to be crucial and it is a key for reaching the goals of a project. These roles and commitments also encourage the lower levels to follow and comply with the regulations which are decided by the leaders. The legal dispute mechanism should be modified by providing an alternative mechanism which has better enforceability of the dispute settlement. Moreover, full commitments are not only required from the leaders but also from their administration such as the central bank, the ministry of finance and the other ministries. Furthermore, there should be an obligation to incorporate such regulations into national law, with which the ASEAN member states will comply. ASEAN may learn from the EU also with regard to the judicial construction.

The author has also noted that the EU has strong and binding rules such as treaties, conventions, regulations, and directives. These regulations were transposed into domestic/national legislation so that the EU law will be recognized and enforced by other EU member states. One of the good examples that can be learnt from is the involvement of the EU Services Directive in the transposition process. Ulrich Stelkeus and his colleagues have studied the involvement of the parties in Netherlands on the implementation of the Services Directive. They observed that besides the respective ministries involved, the private partners such as the social partners and unions, were also consulted during the decision-making process of transposition. The Netherlands has also initiated a screening of their legislation to ascertain whether any inconsistency with the Services Directive exists in their

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798 The higher the law means the higher level of legal power that could be enforced.
799 Ibid., pp.17.
800 The EU Member states also have a Council Regulation (Reg. 44/2001), best known as Brussels I Regulation, which replaces the Brussels Convention 1968, an international convention on the recognition and enforcement of foreign judgments. The Brussels I Regulation employs a harmonized approach to ascertaining which of the EU member state courts should have jurisdiction to proceed a dispute and how judgments from courts in one EU member state should be recognized and enforced in another EU member states. This regulation obliges the member countries to transpose the EU regulation into national law. The Regulation 44/2001 has been superseded by Regulation (EC) 1215/2012 (“Recast Brussels I Regulation”) which shall apply from 10th January 2015.
802 Ibid., pp.448.
legal system. These measures are good examples in the decision-making process of a regulation for a project in ASEAN.

From the description above, the author concludes that when ASEAN decides to start drafting a treaty or a regulation, it should have a clause, which requires that it be transposed in a national law or directly applicable, in order to be recognized and enforced in the respective member state’s jurisdictions. Once the regulations have been transposed in each national law and recognized in all concerned jurisdictions, then the regulations shall apply to all related courts, which could resolve the conflict of law issues.

With regard to the initiative of the ASEAN-ARTS, this mechanism will implicitly comply with the PFMI and the CP-SIPS, principle no.1. Of course this system needs a well-managed dissemination and education effort to relevant bodies i.e. all ministries, parliament and courts, as well as the private sectors in order to increase awareness before the implementation of such regulations. ASEAN should become an organization that is based on the rule of law.

Furthermore, legally binding decisions, finality of judgment and enforceability are essential to any dispute resolution process between parties. The author suggests that arbitration is one of the suitable mechanisms to answer these challenges, because the United Nations New York Arbitration Convention of 1958 allows the enforcement of an arbitral award in member countries who joined this conventions. Moreover, ASEAN has already had consultation and mediation as a dispute settlement mechanism. The arbitration dispute mechanism can also strengthen ASEAN for settling disputes. This would provide more options for member states to settle their dispute, without seeking out other fora. So, the author suggests to modify and to refine the Dispute Settlement Mechanism of ASEAN by providing more options for settling disputes.

In relation to the process of transposition of regulations into national law, the author observes that the role of non-state actors are also a critical part of the equation. A smooth coordination between related ministries as well as with the legislative body is also one of the major factors for a successful transposition of the regulations into national law. Additionally, a better dissemination and education to the society should also be taken into account, as public awareness about such regulations.

With regard to the creation of the regulations at a transnational level, ASEAN should have a competent authorized body to administer, monitor, and create binding rules for a project. While observing the EC’s authority, the author has become inspired by the insight of the theory of Alec Stone Sweet and Wayne Sandholtz. They are of the opinion that an

803Ibid., pp.462.
804See further in sub chapters on CP-SIPS and PFMI which are a legal basis or legal foundation to implement the integrated payment system.
integration is the process by which the EC gradually, but comprehensively, replaces the nation state in all its functions. On the one hand, since ASEAN has the ASEAN Secretariat, the author notes that it is necessary to empower, widen and enlarge the ASEAN Secretariat’s authority in the policy-making, in order to efficiently and effectively carry out its administration. On the other hand, there should be a willingness from the ASEAN leaders to render their power to some degree to the ASEAN Secretariat and utilize the existing body/bodies for coordination.

Above and beyond, the ASEAN Charter is one of the fundamental regulations that need to be reformed. The ASEAN Charter should provide more room for ASEAN as an organization to play bigger roles within its region. Restructuring the functions of the ASEAN bodies is also one of the important steps in facing the AEC 2015, and in facing the challenges of other regions. The author believes that the competence of the ASEAN Secretariat in managing the administration of the region will represent all members’ interests in dealing with the global world in the future. Nevertheless, the author acknowledges that this matter is one of a very delicate and sensitive nature for the ASEAN Leaders, not only due to the need of surrendering political power in favour of the Association, but also due to since it means partially giving up their sovereignty. These appear to be the main reasons for the reluctance of the ASEAN leaders to adopt a supranational governance. However, the demands triggered by the political, the economic, and the legal globalization, are unavoidable for ASEAN, and it has to develop new institutions and/or to restructure its current bodies which eventually could bring stability and legitimacy to the association. The author is inspired by the statement of Capannelli and Tan, which are of the following opinion:

“Several reforms and innovations are needed to strengthen Asia’s institutions for regionalism. The governance of existing institutions should be strengthened and made more effective and participatory, giving larger space to civil society and the private sector to contribute to defining their priorities and agenda, together with government agencies. Regional institutions should also be given more delegated powers to act on behalf of their member countries in order to improve regional commons, as well as more financial and human resources. Regional stakeholders should consider phasing out institutions which have already accomplished their mandate or which are no more effective, and creating new institutions whenever needed. At the same time, it bears reminding that regional institutions are rooted in regional order. Institutional efficacy as such is equally dependent on the ability and willingness of their members, especially great powers and influential stakeholders, to collaborate.”

From the description above, the author has drawn several conclusions.

805 Alec Stone Sweet and Wayne Sandholtz, “European Integration and Supranational Governance”, Op. cit., pp.299. They both were inspired by two of the founders of the integration theory, Karl Deutsch and Ernst Haas.

- First, the author wants to emphasize that ASEAN is not the EU, so ASEAN cannot be compared to the EU and ASEAN cannot use the EU as a model; however, to a certain extent, ASEAN may learn from the EU, for example from its legal structure. ASEAN is not aiming at becoming fully integrated, like the EU is, but solely at forming a single market for ASEAN.

- Secondly, ASEAN should put the rule of law in place again. A legally binding agreement such as a treaty should be re-established and should become one of the characteristics of ASEAN in order to provide legal certainty and a structured legal framework for every future project created by ASEAN. So, a legal structure and a legal framework are one of the very important elements for establishing and implementing a project. Every project of ASEAN should be based on community legislation, or as the author prefers to call it, the ASEAN law, so that the ASEAN member states could adjust their national laws in conformity with such a legal umbrella. Moreover, in order to prevent contradictions between the community law and national laws, the community legislation should be considered as a supremacy law. So, the community law, which has a direct effect and is part of the national legal order, will be applicable in all the member states, to both institutions and individuals.

- Thirdly, the strong need of restructuring of policies and the functions of the competent bodies in the ASEAN organization is necessary to bring more legitimacy and stability to the association. Singh argues that regionalization will be achieved only through audacious attempts to institutionalize democratic norms as well as enhanced mechanisms pooling sovereignty. So, ASEAN must have the necessary policies and infrastructure in place in order to cope with the need for financial integration and single market in attaining the AEC 2015. In the future, ASEAN should consider having an institutional body or set of bodies, which could manage the regions’ matters. For settling any disputes, for example, ASEAN would need to empower the Dispute Settlement Mechanism to become an entity like a Region Judicial Forum, by complementing an effective compliance mechanism with legally binding decisions which are able to force members to comply, so that every dispute between member states can be settled in such a forum.

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807 See Bangkok Declaration, on chapter 3 sub. 1.4.
- Fourthly, the necessity of a strong political will from the governments as well as from other elements such as the legislative and judicial bodies are required to support this project, especially with regard to legal aspects. A well-managed dissemination and education to the public in order to provide awareness and readiness of the society regarding the project should also be taken into consideration.

- Fifthly, the cooperation of public-private partnership is an utmost requirement in order to increase and enhance the financial integration within ASEAN. Private sectors are more aware of the problems in the field. Their participation in the policy-making process is indispensable. Additionally, the non-state actors or known as Non-Governmental Organizations (NGOs), also play an important role in bringing and influencing issues at a regional level. Their role is to influence policies through participation in the entire policy-making process. Lastly, former high-level officials also play a key role to support and to influence the policy-making process. The author observes that they have the skills and knowledge that could influence and assist the policy makers in taking a decision. The role of these two elements will foster a greater ASEAN economic integration.

- Last but not least, this analysis also finds the necessity of empowering the ASEAN Secretariat with more legal power, institutional mechanism, regional autonomy and human capitals as well as increased funding, are fundamental in order to perform ASEAN’s programs efficiently and effectively and to pay more attention to attracting the countries outside region to cooperate with ASEAN. ASEAN still remains powerless with no central role, and it is understaffed and lacks finance. Reforming the Charter is not a sin; it can be done by achieving willingness and full commitment for a very good collaboration and coordination among members, especially their leaders and their administrations.

With regard to the initiative of ASEAN-ARTS, the author recommends that it becomes one of the tools to be considered in the support of the AEC 2015 in line with this proposal. This dissertation also provides a better understanding on the necessity of creating a payment system (RTGS) integration in ASEAN by explaining the background behind the creation of

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811 See chapter 3 sub chapter 2.9. ASEAN also have made co-operation with NSA such as the ASEAN-Institutes of Strategic and International Studies (ASEAN-ISIS) and the Institute for Southeast Asian Studies (ISEAS) which have provided valuable contribution to ASEAN. To see further these two NGOs see at [http://www.isis.org.my/index.php?option=com_content&view=article&id=612&Itemid=56](http://www.isis.org.my/index.php?option=com_content&view=article&id=612&Itemid=56) and [http://www.iseas.edu.sg/mission.cfm](http://www.iseas.edu.sg/mission.cfm), last accessed on January 28, 2015.

TARGET. The author would like to ensure that the proposal of establishing ASEAN-ARTS is applicable and relevant for supporting ASEAN’s objectives to face the challenges of AEC 2015. ASEAN may learn from the way the EU governs, through the rules and procedures of TARGET and implements it by making some adjustments and filtrations in accordance with ASEAN’s identity and characters. It is acknowledged that TARGET is one of the best systems for payment transactions and settlement. It has a systematic scheme, in terms of both structural organization and regulations. Good examples are its regulations which are directives or guidelines govern a (requisite) clause, namely transposition clause, which the member states or the NCBs should comply with.\footnote{See the example of Directives and/or Guidelines. Art. 28 ECB/2012/27 Guideline of the ECB of 5 December 2012 on a TARGET2 and Art. 11 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems and Art.12 of Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters.} Moreover, they have a statute, which states that the regulations shall be binding in their entirety and are directly applicable in all Euro area countries.\footnote{See Article 34.2 of the ESCB Statute.} These regulations make TARGET becomes one of the best payment systems in the world for providing a structured legal framework.

With respect to the ASEAN-ARTS initiative, the author has several conclusions and recommendations, which include the following:

- This initiative is applicable and relevant to supporting the objectives of the AEC 2015 and the objectives of the WC-PSS. The author suggests to make this initiative part of the Blueprint of the WC-PSS on the trade settlement area.

- This initiative should be based on a legally-binding regulation, which has a governing law, jurisdiction and transposition clauses. These provisions will provide legal certainty to all members, and finally these will protect the customers. Moreover, the rules and procedures must also be part of the regulation. It is expected that such a legally-binding regulation may also be transposed into national law to fulfil compliance with the Principle of Financial Market Infrastructure (PFMI) and the Core Principle on Systematically Important Payment System (CP-SIPS), especially principle no.1. This legal unification will simplify the process of disputes in multiple jurisdictions.

- It appears to the author that the existing dispute settlement mechanism lacks enforceability of its judgments. ASEAN should empower the dispute settlement body as a proper judicial body, which all members must comply with and whose decisions are enforced by all the ASEAN members in resolving regional disputes. This will be done by conducting an alternative dispute resolution mechanism, which shall provide legal certainty to the parties. ASEAN needs a more attractive
mechanism that fits the needs of its members. An ad hoc arbitration\textsuperscript{815} might be a good option/choice of forum due to its effective and efficient process, its legally binding judgments and its ability to be recognized and enforced in all jurisdictions. This mechanism, which is in accordance with the New York Convention, might also be a good alternative mechanism for settling a dispute not only for ASEAN-ARTS, but also for other commercial disputes in the region. Chen and Howes observe that there is no comparable international treaty for the enforcement of foreign court judgment.\textsuperscript{816} It seems to the author that it will be a good start and good step for ASEAN to have an alternative competent legal mechanism that may solve the problems/disputes in the future, so that they do not have to look for other organs outside ASEAN to settle their own problems.

- The author has also observed that in the implementation of TARGET, besides regulations created by the ECB, there are also related regulations that support TARGET as well as other payment systems and economic/commerce activities in general. For example, there are the Payment System Directive (PSD), the Settlement Finality Directive (SFD), the electronic commerce regulations, the Rome Convention and the consumer protection regulations. The author also recommends the creation of such a regulatory framework, which shall be put into consideration by ASEAN in support of the implementation of payment systems in general.

- In the long term, if ASEAN would also like to implement full integration in the monetary and economic sectors, like the European Union, the creation of an ASEAN Central Bank (ACB) as one of the very crucial institutions should also be put on the table. Such vision, of course, has a lot of requirements and elements to be prepared, inventory of problems and stages that need to be measured, including economic convergence that should be assessed with certain criteria, the price stability, the exchange rate fluctuation and the financial condition of the government.\textsuperscript{817} This vision cannot be carried out without caution and good planning. The author hopes that the recommendation on creation of an ACB and the possibility of implementing the ASEAN Union could stimulate further research.

As far as the role of Indonesia is concerned in ASEAN and in the creation of a payment system in supporting programs of the AEC 2015, the author has already described that Indonesia has an important and leading role, representing itself and other members as

\textsuperscript{815}This ad hoc arbitration will have a list of arbitrators who consist of the experts from central banks, banks and other members, so the disputes can be settled efficiently. This recommendation is based on effectiveness and competence.

\textsuperscript{816}Henry Chen and B. Ted Howes, Op cit.

\textsuperscript{817}See chapter 2 sub. 1.2.2.
well, by being actively involved in every international fora, including being appointed as a member of the G20 organization and as a co-chair of the WC-PSS for the period 2010-2015. It has been proven that Indonesia has played a key role in ASEAN. The author has faith in the capability of the new Indonesian leader, Joko Widodo, to represent Indonesia and to continue the country’s role in attaining the AEC 2015, because Indonesia is not only a big and strategic country but it also has great influence by representing ASEAN in other international formats. Indonesia has demonstrated its role from the beginning of the ASEAN commencement until now and it is acknowledged by other ASEAN members as well.

With regard to the challenges of Indonesia related to the domestic arrangements in facing the AEC 2015, the author observes that Indonesia is ready to face the AEC 2015. The following are a few factors that support Indonesia’s readiness to face the AEC 2015:

1. Indonesia has the capacity to become a regional champion in the AEC.\textsuperscript{818} This can be seen from its economic growth amidst a global crisis.

2. Indonesia also has a touristic sector which is characterized by strong competitiveness compared to other ASEAN member countries.\textsuperscript{819} However, this sector needs infrastructure and transportation improvements in order to attract more international tourists.

3. Indonesia has the availability of cheap labour.\textsuperscript{820} The author observes that this sector must be upgraded so that a high productivity employment is achieved by providing trainings, skills, and education for the workers.

4. Indonesia has immense natural resources that can be utilized appropriately. This sector needs deregulations from the respective institutions to foster and sustain a conducive national competitiveness.

5. With respect to the payment system infrastructure, Indonesia, and in particular Bank Indonesia, has already prepared and developed its BI-RTGS into BI-RTGS2, which is expected to conduct delivery vs. payment and payment vs. payment. In its development, BI-RTGS2 is in accordance with the interoperability standard by adopting the ‘swift format’ based on ISO 20022 (technology XML).\textsuperscript{821}

Rendering an account of these factors, the author concludes that Indonesia needs a good strategy and synergy from all elements, not only from the governments, the legislature and the judiciary, but also from non-state actors such as businessmen, associations, professionals and even citizens, which must have common perceptions to face the AEC 2015.

\textsuperscript{819} \textit{Ibid.}, pp.32.
\textsuperscript{820} \textit{Ibid.}, pp.59.
\textsuperscript{821} Based on an interview with officials from Bank Indonesia in October 2013. This technology is an international standard and is generally used by all RTGS systems in the world.
This noble goal needs dissemination and education from authorities to the public in order to provide awareness and better understanding among all individuals on the importance of facing the AEC 2015.

Finally, the author hopes, that this dissertation will contribute to the development of an (clearer understanding on the importance of the) integrated RTGS payment system which will further enhance the economic integration within ASEAN.