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Innovation and the Entrepreneurial State in Asia: Mechanisms of Bond Market Development

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ABSTRACT: *Recent years have seen a rapid expansion of bond markets in East Asia. Asian policy makers have played a pivotal role in this development. They have seen bond market development as a way to mitigate the risk of capital mobility and as a means to channel savings toward economic growth in the region. This development presents an interesting challenge to the developmental state literature associated with bank-based financial systems.*
This paper introduces the concept of the entrepreneurial state to help us better understand the role of government in the construction of these markets by focusing on institutional innovation. Economic analysis typically suggests markets develop spontaneously as countries in the region grow richer. However, this significantly underestimates the politics involved in the process of market development. The developmental state literature explores the politics of resource mobilisation. The idea of the entrepreneurial state departs from these conceptions by focusing upon market creation and development in terms of institutional innovations conducted by states. The entrepreneurial state assumes the role of market participant by constructing quasi-market institutions that do things that elsewhere are done by private institutions.
We will explore three mechanisms of state-led market innovation: national (as opposed to the US-based global) credit rating agencies, mortgage corporations, and bond pricing agencies. National credit rating agencies rate the creditworthiness of debt in local currency. Mortgage corporations create markets in securitised housing loans. Bond pricing agencies put a value on illiquid debt instruments to enable mark-to-market portfolio management. Together these three mechanisms constitute the core elements of what is usually seen as the key determinants of a financial market (demand for creditworthy products, supply of tradeable assets, and the fixing of a price to those assets). These mechanisms influence the nature of market operations by producing outcomes quite different from the ideal type of the free market.

Why Bond Markets?

Financial instruments, such as bonds, are not mere tools, but crucial determinants of the organisation and governance of financial systems and the specific character of credit practices. The shift from an intermediated bank-based financial system to a disintermediated system of market finance and by extension the growing importance of bond finance are significant elements of contemporary social change which warrant explanation. We suggest these processes can help to better understand the ongoing reconfiguration of Asian political

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economies, and of state-market relations more generally. The transformation of financial intermediation has been one of the most significant transformations of the world economy over the last two decades. Nevertheless, so far it has received scant attention in the International Political Economy (IPE) literature (for an exception, see Sinclair 1994a).

The international financial turmoil of the 1970s was a key driver of the (re-)emergence of political economy, mainly in the guise of a newly founded field, International Political Economy. As a consequence of these origins, inter-state relations, international capital mobility and international financial cooperation under conditions of capital mobility continue to remain core interests of IPE. The increasing disintermediation of both domestic financial systems and the international arena (i.e. the rise in international portfolio investment) is often seen as only a by-product of capital mobility, and not as a phenomenon that requires scrutiny itself. This neglect of the significance of financial disintermediation in terms of its political underpinnings, socio-economic consequences, and in its relation to international capital mobility is a serious flaw of a number of, at least in this respect, too vaguely specified accounts of the (re-)emergence and evolution of (global) finance (see e.g. the contributions in Andrews 2006; in Kirshner 2003a; Helleiner 1994, to name only a few; notable exceptions are Sinclair 1994a; 2005; French and Leyshon 2004; Lavelle 2004; Sobel 1999; 1998; 1994).

So what are bonds? Essentially, bonds are debt certificates specifying the relationship between creditor and debtor. They state the sum that is lent and the debtor's obligation towards the creditor. They are also referred to as securities, debentures or obligations. What distinguishes bond debt from the other major form of debt provided by the formal financial system, bank loans, is that bonds are easily transferable. Through bonds, a loan is broken up into smaller denominations and usually claims are marketable, meaning that they can be bought and sold in a secondary market. As a consequence, bonds are more liquid than traditional bank loans. They are a very 'mobile' form of capital (Watson 2007; 1999). This characteristic of mobility has implications for the role of bond finance as a *mode* of financing, i.e. the way credit is created and allocated. The progressively more important role of bond markets as a source of funds coincides with the more general paradigm shift from bank-intermediated finance to disintermediated market finance. This shift is more pervasive than commonly perceived and the economies of a series of emerging countries in Asia have succumbed to this trend

Bonds are used - and bond markets are developed - to mobilise credit. As Bagehot pointed out in 1873 (I.4), the development of the financial system influences and is in turn influenced by the extent to which money is 'borrowable' or has liquidity. It is often assumed that by increasing the number of instruments through which money can be saved, bonds being one of them, a larger volume of savings can be mobilised. Importantly, liquidity affects who has access to credit and at what price. As a consequence, within existing financial structures the effects of increased liquidity are rarely neutral. Liquidity can exacerbate the uneven distribution of financial resources, making credit more easily obtained, in larger amounts and at cheaper rates for some, excluding others (Leyshon and Thrift 1997). In other words, there is a systemic component to the allocation of credit, which is ignored by the equilibrium models of neoclassical economics. Accordingly, more attention needs to be paid to the institutional arrangements that determine access to and allocation of credit and within which efforts to expand bond markets are undertaken.

In a bank-based financial system, credit is intermediated by banks. No direct relationship exists between lenders and borrowers as banks act as 'go-betweens'. They take deposits and make loans. In addition, they screen applicants for loans and monitor loans once extended. In this ideal-typical scenario, bank income is the difference between the interest paid to depositors and that received from lenders. Indeed, as profit-making enterprises, banks are 'more than neutral "go-betweens"' (Palazzo and Rethel 2008, p. 195). Often, but not always, the relationship between bank and borrower is based on long-term considerations, an arrangement sometimes termed 'relational capitalism' whereas capital markets tend to be characterised by a synchronic logic of short-term profit maximisation (Dezalay and Garth 1997; see also Sinclair 2005; Harmes 1998).

The shift from a bank-intermediated financial system to a system of disintermediated market finance does not make banks superfluous, but fundamentally changes their role (Howarth and Hardie 2011; Rybczynski 1997). Essentially, banks remain banks only in name. Interest income is downgraded. Instead, banks derive their income from fees for underwriting, consultancy and other activities, which change the incentive structure under which they operate, thus arguably contributing to a more short-term orientation to their business (Ertürk and Solari 2007). Commercial banking activity becomes relatively less important in proportion to investment banking. Relational capitalism is replaced by 'arms-length' capitalism and more selective bank-borrower relationships (Rajan 1992; Zysman 1983). In so doing, the shift towards disintermediated finance affects both access to and distribution of financial resources.

Bond finance not only changes the quantity of funds available, but also how funds are redistributed between borrowers, lenders and intermediaries. It thus affects power relationships in finance. The shift from bank to bond finance also influences the allocation of credit. The reasoning here is as follows. Raising capital via bond issuance is only economically rational for companies which have achieved a certain size. Similarly, reputation is crucial in arms-length markets like bond markets, which privilege firms with a good credit history. Altogether, bond financing is favourable to big, long-established companies, but costly and more difficult to obtain for smaller and younger entities (thus, for example, the higher interest rates on so-called junk bonds in the Western world and the absence of this type of financial instrument in many Asian economies).

The asymmetric effects of bond finance are exacerbated by the fact that the control of companies of different sizes and reputations is unevenly distributed across income class, ethnicity and gender. Thus, political efforts to develop bond markets, and to prioritise the use of bond finance over the promotion of other financial instruments, can have significant effects on social and economic mobility within a society. To some extent, this domestic scenario can also be applied to the international level and sovereign borrowing. More generally, advanced nations with a high credit rating (e.g. AAA or AA) obtain funds at a cheaper rate than emerging economies. Furthermore, the least developed countries do not have any access to private capital markets. For example, in a study analysing the borrowing behaviour of developing sovereigns, Gelos et al. (2004) found that out of their sample of 143 developing countries, 51 did not have access to international capital markets. Another 78 countries had only occasional access (Lensink and White 1998).

Creditworthiness, narrowly defined as debt repayment capacity, emerges as a central issue. In a world of capital market-oriented finance, the screening and monitoring of loans is no longer a responsibility of banks but is that of investors and institutions operating on investors' behalf such as credit rating agencies (Sinclair 2005; 1994a; 1994b). To attract capital, borrowers (both sovereign and corporate) have to send certain signals upon which their creditworthiness is established in the eyes of investors. An important consequence of this is that, in a securitised or disintermediated system, financial analysts gain power, whilst investors and investing institutions increasingly look to them and not to the managers of corporations (and by association, countries) when making judgements of whether to invest or not (Perry and Nölke 2006). A further consequence is that investment assessment and decisions are separated. However, the assessment remains centralised in that the nodal point for information and judgement-making often is only a handful of organisations (for example, there exist only two or three internationally renowned bond rating agencies, Standard & Poor's, Moody's and perhaps Fitch). Borrowers are disciplined by making their credit more expensive (i.e. raising the interest rate). This endows disintermediated financial markets with a certain structural power.

Modern finance theory generally assumes that the development of bond markets helps to diversify risk by broadening the range of assets for investment. Bond finance provides the basis for securitisation. Securitisation refers to a process in which loans, or more specifically the future cash flows to be generated from these loans, are pooled and sold on in the form of bonds. These loans can be of various origins, for example mortgages, or consumer loans such as car loans or credit card receivables. In so doing, securitisation effectively converts real assets and claims into liquid financial claims. The effects of securitisation are pervasive. By selling on loans, banks can take them off their balance sheets and thus, it is thought, reduce their risk exposure.

Moreover, by releasing capital, securitisation also enhances liquidity, assuming market participants have confidence in the securitised assets. In theory, securitisation aids the diversification of risk and could thus potentially lead to a more stable financial system (CGFS 2007 and 2003). Yet in practice, due to the separation of originating and holding risk, securitisation has tended to increase risk, as demonstrated in the global financial crisis that began in 2007 (Best 2010; Langley 2008b; Lordon 2007; De Goede 2004).

The organisational structure of bond markets provides ample room for collective action problems (cf. Olson 1971). While in a bank-intermediated financial system decisions on the allocation of credit are centralised in the hands of a few banks, in a securitised economy they are, *prima facie*, made by a larger group of individual and institutional investors which purchase and hold the small denominated debt certificates, although with the qualification that crucial inputs like credit rating provision are highly centralised. The tradability of bonds means that often not even the original contracting parties meet in case the debt needs to be renegotiated. However, bond markets are not atomised markets as posited by the ideal type market model of neoclassical economics. Investment decisions are to a large extent in the hands of unit trusts or mutual funds, and other institutional investors. A clear hierarchy exists between institutional and individual investors. Investors vary in terms of human capital and information resources, dependent on the amount of investable funds they control. Conflicts of interest are inherent in this system (Palazzo and Rethel 2008). Indeed, in a disintermediated financial system, the allocation decision becomes anonymised, but not atomised (Watson 2007).

At first glance, for some the increasing salience of bond finance seems to be a rather negligible technical issue. However, we claim it is wrong to see financing methods as mere tools, a side-track from more important 'political' analysis, with the political being narrowly conceived as inter-state relations, and not worthy of scrutiny on their own (cf. Sobel 1999). Financing methods, and the importance attributed to them within specific financial system configurations, are at the core of the everyday reproduction of financial orders (cf. Seabrooke 2006). Above all, bond finance creates an 'economy of obligation' as the historian Craig Muldrew (1998) has argued. It gives rise to a new politics of debt. Hence, not only do the immediate distributional effects of bond market development have to be considered but also the intermediate effects on the expectations, belief systems and behaviour of borrowers, lenders, and financial market actors more broadly. In an emerging market society, where many changes are occurring at the same time, the impact may be significant.

The apolitical accounts provided by economistic-functionalist explanations of bond finance specifically, and the role of financial systems more generally, is problematic. They ignore the power relations associated with bond finance as well as the role of bond markets in broader processes of economic and societal transformation. By granting certain actors enhanced access to finance, the expansion of bond finance is an important determinant of social mobility. However, these socio-economic dynamics of bond markets have also been neglected by much of the IPE literature. The attention this pays to bond markets has been dominated by a preoccupation with the relationship between *international* bond investors and *national* policy autonomy. An artificial dichotomy is created between *international* markets and *national* policy autonomy. Yet, domestic bond markets also constitute a source of market power and discipline, especially as they are becoming more significant in size and as providers of capital following recent (state) efforts to develop them in Asia.

The development of bond markets both induces and is premised on qualitative and institutional changes in the working of the state and its agencies in relation to both the financial system and the wider political economy. In so doing, it fundamentally affects economic policymaking. While in traditionally bank-intermediated systems such as for example the various configurations of Asian developmental states, the state acts as steward of the banks and the financial system. In a disintermediated market finance setting, endorsing and enforcing rules becomes a crucial function. Lenders look to the state to ensure their creditor rights. Indeed, instead of the 'retreat of the state' as foreseen by Strange (1996), states should be understood as crucial endorsers and enforcers of rules (Weiss 1998; Vogel 1996). Capital markets thrive on (liberal) rules. This is clearly illustrated by the importance attributed to the enforcement of property rights in the growth of capital markets (La Porta et al. 1998).

The significance of rules, regulations and other signalling mechanisms increases, given the costs to individual investors of obtaining and processing information. Hence, the shift from a bank-intermediated to a disintermediated financial system is dependent on the state as a signalling institution, as a provider of information and as an enforcement agent. While 'epistemic authority' is conceded to private information institutions such as bond rating agencies and performance indices, it is wrong to see this as a zero-sum game (Sinclair 2005; De Goede 2005). State and market are mutually dependent and mutually constitutive. Private forms of authority to a large extent depend on their endorsement by policymakers (Abdelal 2007). The state derives legitimacy in the eyes of the public (and its creditors) from both its economic success and financial creditworthiness. Thus, instead of asking to what extent the state is forced to retreat, attention should be paid to qualitative changes in the form of state and the changing role states play, especially the inducement of institutional changes in favour of transparency and how increasing demands for transparency affect the scope for discretionary policymaking (Best 2005). Yet, arguably the state plays a much more fundamental role. As we will outline in the following section, more attention must be paid to the constitutive role of the state in the making of these markets.

Bond finance and bond markets matter. The development of bond markets affects how savings are mobilised; it affects the principles according to which credit is allocated (and thus influences who has access to credit and at what price); it manipulates the distribution of risk and reward; and it acts as a source of discipline. With reference to the Asian experience, in the following empirical discussion, we will inquire in more depth into the basic characteristics of bond markets and the conditions of their emergence and development.

From developmental State to entrepreneurial State

In emerging and developing countries banks used to be a linchpin of development policy (Zhang 2009; Wade 2004; Amsden 1989; Johnson 1982; Gerschenkron 1962). More specifically, bank-intermediated financial systems were the cornerstones of various Asian developmental state models. The ideal type developmental state model was based on a bank-intermediated financial system (see e.g. Zhang 2009; Wade 2004; Amsden 1989; Johnson 1982; Gerschenkron 1962). In the late-industrialising Asian economies, restrictions on the financial system were used as a deliberate development strategy to pursue economic growth (Gerschenkron 1962). Selective credit programmes directed funds to sectors and industries which governments identified as important for the country's economic transformation in a process referred to as 'picking winners' by hostile developed country economists. Chalmers Johnson (1982) termed this the 'capitalist developmental state', while Wade (2004) uses the concept of the 'governed market'. The cornerstone of the developmental state system was the government-led pursuit of economic growth via a bank-intermediated financial system (Öniş 1991). Financing choices tended to favour bank debt rather than equity, with financial systems characteristically being little diversified. Banks provided the capital necessary for development. In return, the state safeguarded the interests of the banks and imposed high barriers to entry (Haggard and Lee 1993).

According to advocates of the developmental state model, short-term market logic would not generate the required long-term investment necessary for industrialisation. Instead, they advocated a system where the government 'encouraged' investment in targeted sectors and segments of the economy which were identified as crucial to bring about economic transformation. To this purpose, prices were 'wrong' on purpose as the allocation of capital did not necessarily follow a (short term) market logic (Amsden 1989). However, some argued further that the state was not only reallocating financial resources from one thing to another, but could also mobilise funds and stimulate investment (Wade 2004). Nevertheless, the allocation of credit was clearly geared towards big business, which also was better able to generate funds internally. In addition, risk was very concentrated, which made this model of 'indebted industrialisation' highly vulnerable to shocks (Bowie and Unger 1997, p. 13; see also Wade and Veneroso 1998). It relied on a certain degree of insulation from the world economy (e.g. through capital controls and restrictions). Moreover, as state development planning agencies monitored industries and made overall investment decisions, banks had only a limited disciplinary function over business activity.

In the interventionist developmental state model, which sought to regulate investment much like the rules of the road regulate driving, both the capital needs of households and small enterprises were seen as subordinate to the overarching goal of national economic growth. Finance was subordinated to the needs of the 'real', industrial economy and designed to serve industrial strategy. As Wade (2004, p. 27) points out, a key feature of the developmental state was its control over the financial system, 'making private financial capital subordinate to industrial capital'. Yet, state control of the financial sector was also used to further other socio-economic goals such as, for example in the case of Malaysia, the indigenisation of the financial system and the redistribution of corporate ownership along ethnic lines. The transition to a disintermediated system of market finance provides fundamental challenges to this developmental state model.

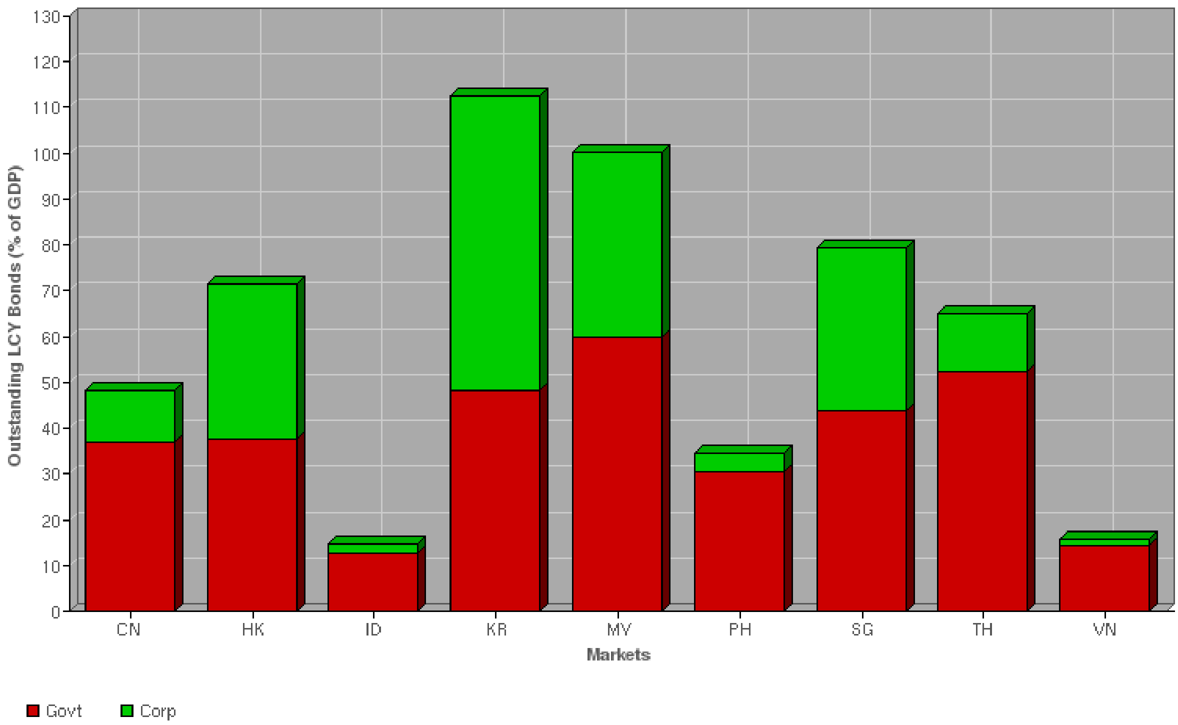
Significant structural changes in the world economy over the last two decades have seriously altered the context within which Asian developmental states operated. As the East Asian economies became increasingly integrated with the world economy, it was more difficult to afford the insulation necessary to maintain the developmental state system of old. Similarly, capital markets increasingly competed with banks as main sources of funding. Major pillars of the old developmental state system were gone. The expansion of bond markets has played an important role in this regard.

We argue that since the Asian financial crisis the state form that has characterised emerging Asia has shifted substantially from the developmental state to what we call the entrepreneurial state. Given the changed context outlined above the strategy of 'picking winners' is no longer dynamic enough for a world in which technologies and financial innovations are rapidly introduced and seemingly just as rapidly become obsolete. Nor is the developed world neoliberal state form that merely seeks to create the right conditions for innovation attractive in the context of Asian challenges and ambitions. Our conception of the entrepreneurial state acknowledges that cooperation between market participants in developing new institutions and processes is often difficult. States are able to knit together large networks and encourage their cooperation. Think of a telephone network eighty years ago or Facebook today. The entrepreneurial state is not simply trying to do development itself. It recognises positive dynamics such as 'network effects' and the incentives some established companies have to be rent-seekers and obstruct change, as obsolete state forms have historically. The entrepreneurial state is focused on institutional innovation at a deeper, constitutive level, recognising the limitations of picking winners (characteristic of the developmental state) and of merely getting the environment right (developed countries after about 1980). The entrepreneurial state is now characteristic of emerging Asia and nowhere is this role clearer than in the catalyst function the entrepreneurial state has served in developing bond markets in the region. In turn, the emergence of bond markets has facilitated the process of state transformation from developmental to entrepreneurial state.

Finance as site of state transformation: The development of bond markets in Asia

Recent years have seen the rapid expansion of local currency bond markets in Asia. In the wake of the Asian financial crisis, policymakers perceived the development of regional bond markets as a way to deal with the double mismatch of short-term, dollar-denominated borrowing for long-term, local currency investments, whose flaws became so apparent in the Asian financial crisis (Katada 2009, p. 11). In addition, developing and promoting regional bond markets is an attempt to improve the financial infrastructure to retain savings in the region, especially as the required investments for regional infrastructure development are deemed high (see e.g. Kawai 2006 as quoted in Dent 2008, p. 775). Indeed, Asian countries are renowned for their comparatively high savings rate and policymakers are keen to recycle these savings regionally (Rethel 2010). Figure 1 shows the volume of local currency bond market as a percentage of GDP for a range of East and Southeast Asian countries.

Figure 1: The Size of Asian Local Currency Bond Markets (% of GDP)



Source: http://asianbondsonline.adb.org/regional/data/bondmarket.php?code=LCY_in_GDP_Local

In the following, we will focus on three mechanisms of bond market development: credit ratings; securitisation via mortgage corporations; and bond valuations by bond pricing agencies and similar institutions. These three institutional devices mirror the core elements of the market: demand, supply and price. Credit ratings confer bonds with creditworthiness. They thus influence the demand for this type of financial instrument. Mortgage corporations turn mortgages into debt securities and thus act as suppliers of this type of financial instruments. Taken together, these three types of institutional innovation – whose emergence was facilitated by the entrepreneurial state - mimic the operation of the free market. In so doing, the development of national currency bond markets has also contributed to the further consolidation of the entrepreneurial state model.

National credit rating agencies

Japan was the first country in Asia to have local credit rating agencies, starting in the mid-1980s. The Ministry of Finance was heavily involved in their creation and few market observers saw them as independent or took them seriously for many years (Sinclair 2005). Twenty-five years after their founding two Japanese agencies have been recognised by the US Securities and Exchange Commission as Nationally Recognized Statistical Rating Organizations, like Moody's and Standard and Poor's. This pattern of development is distinct from the US experience in which investors in New York and Europe lacked information on investment opportunities in the American hinterland after the US Civil War. The US Government did not provide much in the way of statistical information and private companies were formed to gather and publish data on railroads and land sales, amongst other things. In 1916 Moody's started to issue ratings on these investments. As time went by US government agencies (and the agencies of US states too) made increasing use of ratings to regulate pension fund investment. NRSRO designation, controlling entry to the rating market, only begins in 1975 when the system of credit ratings had been established in the markets for more than half a century.

Why might emerging Asian states want their own rating agencies to encourage bond market development in Asia when they can make use of Moody's and S&P? The typical reason offered by NCRAs in Korea, Indonesia, and Thailand is that they have superior knowledge of local conditions. This claim has always been disputed by the global agencies where they have set up shop, such as in Japan. But Japan has for decades been part of the circuit of global finance where comparability between credit risks in Los Angeles and in Yokohama makes sense for investors outside Japan. A more likely explanation is that the Global Credit Rating Agencies (GCRAs) based in the US did not deem local bond markets in Asia outside Japan profitable enough, given their – at least until very recently - small scale. The experience of Malaysia in the late 1980s is instructive. Here, the impulse to set up a rating agency came from both domestic regulators and international and regional multilateral organisations such as the International Finance Corporation (IFC; the private sector arm of the World Bank Group) and the Asian Development Bank (ADB). At the time, domestic policymakers were open to linking their new domestic institutions with global networks, and favoured a model where two rating agencies were set up in Malaysia, one in cooperation with Standard & Poor's and the other with Moody's. However, although the GCRAs did this sort of link-up elsewhere the US-based agencies had little interest in this approach in Maalaysia. The Malaysian bond market was small and profits were seen as being too low for them to become active in the market (Interview RAM; Nor Mohamed 2004).[3] Nevertheless, in 1990 Rating Agency Malaysia Berhad (RAM) was incorporated. Its first CEO was a long serving official from the Malaysian central bank who had additional experience of working in the Ministry of Finance. It was the state which ensured that this market infrastructure was built. In 1995 a second rating agency, Malaysian Rating Corporation Berhad (MARC), was established. Financial policymakers thought that a more competitive market for credit ratings would improve their quality and thus further contribute to a mature, fully developed and internationally competitive bond market.

[3] Domestic debt markets were still of little importance. The rating of internationally issued sovereign bonds, however, especially from emerging markets, was seen as a major growth business (cf. Sinclair 2005, pp. 145-147).

By setting up national credit rating agencies, entrepreneurial states responded to a perceived gap in domestic financial infrastructures. In so doing, they played a constitutive role, independent of whether they were the principal shareholders, or these agencies were prima facie privately owned. This suggests the entrepreneurial state does not have the post-colonial impulse toward control typical of its predecessor. Those politics are no longer compelling. The entrepreneurial state is much more interested in performance and achieving objectives.

National agencies may be better able to serve locally-focused investors interested in SMEs (Asian Development Bank 2010: 2). Given the smaller scale of these agencies their fees are more modest than those charged by Moody's and S&P. Moreover, following the rapid expansion of local bond markets since the Asian financial crisis of 1997-8, a growing number of business alliances with the international CRAs have been struck as we will discuss below (see also table 1).

From an international point of view Asian NCRAs remain relatively small and have few reputational assets compared to the GCRAs. The idea that NCRAs are inherently compromised by state involvement and financial sector ownership, as is typically the case, is perhaps a less compelling concern given the problems with GCRAs that emerged during the global financial crisis that began in 2007. The NCRAs have mostly signed up to the IOSCO code of conduct for credit rating agencies, demonstrating a determination to improve the quality of their output and increase their reputational assets over time. As was the case with the Japanese agencies, it will probably take many years to build these agencies into significant institutions that are perceived to be independent and authoritative in their own right outside of their immediate national context, even if some of them already have substantial market share in countries such as Malaysia and Korea. The privatisation of Korea Ratings in 1999 should be seen as part of this process of authority enhancement, in which the entrepreneurial state, having done its job, is able to let the new quasi-market institution take on greater market characteristics. The impulse to on-going control that seems to have been part of the developmental state is largely absent from the operating code of the entrepreneurial state.

On the regional level, there is the Association of Credit Rating Agencies Asia (ACRAA). Its 26 members include rating agencies from the East Asia region, but also from outside countries such as India, Pakistan and Bahrain (Islamic International Rating Agency). Its efforts to promote Asian bond markets are primarily targeted at the exchange of information and knowledge, for example through its regular 'Best Practice Dialogue', and training. In addition to this initiative on the regional level, there is a crisscrossing of links between different national agencies. For example, CRISIL of India was instrumental in setting up Malaysia's RAM, which in turn got involved in Indonesia's PEFINDO, and those are only some of the existing linkages between the agencies. The willingness of states to foster regional links and where attractive, links between NCRAs and GCRAs, suggest the entrepreneurial state is highly flexible and adaptable. This is not the protectionist state that must have its steel factory. The entrepreneurial state in Asia seems to work like a (good) operating system in a computer: happy to make programs work together when needed to serve the needs of the user.

Table 1: National Credit Rating Agencies – Selected Characteristics

	Indonesia	*South Korea*				*Malaysia*		*Thailand*
Name	**PEFINDO**	**KIS**	**KR**	**NICE**	**SCI**	**RAM**	**MARC**	**TRIS**
Created	1993	1985	1983	1986	1992	1990	1995	1993
First rating	1994 operating licence	1985	1987	1987	2000	1992		
Ownership	Private limited		1999 Privatis			Set up as		

	liability company. Owned by 92 domestic institutional shareholders(pension funds, banks, insurers, Indonesia Stock Exchange (IDX) and securities companies) (as of Dec 2009)		ation			private company; however, close links to government. Originally 55 shareholders, now 30 (including ADB, Fitch)		
Business alliances	1996 S&P's (first mainly TA-based)	1998 Moody's	1999 Fitch	2000 R&I	2000 JCR	Fitch owns 5%; strategic cooperation with S&P's	1995 dual rating: MARC local & Thomson BankWatch (now Fitch) international	1993 S&P's (TA only)

Sources: Korea Investors Service, Inc. (KIS); Korea Ratings Corporation (Korea Ratings); NICE Investors Service Co., Ltd. (NICE); Seoul Credit Rating & Information, Inc. (SCRI); Malaysian Rating Corporation Berhad (MARC); Rating Agency Malaysia Berhad (RAM); PEFINDO Credit Rating Indonesia (PEFINDO); TRIS Rating Co. Limited (TRIS)

State involvement in these agencies does not take either a developmental or neoliberal form. States are not forcing private capital to stop using banks. Nor are states sitting back and letting the market develop whatever institutions are required as was the case in the US after the Civil War. Asian states have - however implicitly - recognised the benefits of network effects in promoting this system. In this regard what we call the entrepreneurial state is playing a much deeper and longer term game than the developmental state that preceded it. Network effects have a social or organic quality to them and time is clearly crucial to their development. What comes out of this promotion of innovation is, unlike building a ship yard or steel factory, often uncertain and unexpected, like the emergence of Silicon Valley and software as a major American comparative advantage in the 1990s. In this sense the entrepreneurial state is not like a referee at a football game, imposing the rules when needed. The entrepreneurial state is more akin to a gardener, with some good ideas, but having to deal with uncertainties like the weather, and never too sure of what precisely will flourish and what will perish.

Mortgage corporations

The establishment of the first mortgage corporation in the region took place in the 1980s. Cagamas Berhad, the Malaysian Mortgage Corporation, was modelled on the US mortgage agencies, Freddy Mac and Fannie Mae (Danaharta 2002, p. 51). Set up in the wake of the 1985-6 economic crisis primarily to provide mortgage lenders with liquidity and thus indirectly to contribute to the provision of housing, Cagamas' aims with regard to the development of the bond market were twofold. Cagamas' biggest shareholder - with 20 percent - is Malaysia's central bank. On the one hand, it was thought that by setting a precedent, Cagamas would kick-start the development of the private debt securities market. On the other hand, it functioned as a kind of test case to try out mechanisms for the liberalisation of the government bond market (BNM 1999). In connection with the recent events surrounding the subprime crisis, the US mortgage agencies, and the securitisation strategies they promoted, have drawn a lot of attention and criticism. Thus, it is important to highlight the differences in Cagamas' original operating procedures. Indeed, the early Cagamas bonds were different from typical mortgage-backed securitisation instruments. Cagamas bought housing loans with recourse to the primary lender, therefore not taking on the credit risk, at least for the time being (Cagamas 2006, p. 16). As in the case of NCRAs, it is impossible to see the creation of Cagamas as the straightforward outcome of either neoliberal- or developmental-type state efforts. At that time, the Malaysian bond market was in its infancy. The NCRAs had not yet been established and, in the absence of a corporate bond market, the only available price indicators derived from a non-competitive government securities market in which bonds were held by captive lenders.

The establishment of mortgage corporations (MCs) and the concomitant introduction of advanced securitisation techniques in emerging Asian bond markets gained momentum with the Asian financial crisis. Both Korea and Thailand created mortgage corporations in the wake of the crisis; in 1997 Secondary Mortgage Corporation (SMC) was established in Thailand and in 1999 Korea Mortgage Corporation was created as a joint venture with the IFC.[4] Similarly, Cagamas conducted its first full securitisation transaction in 1999. In 2004, Korea Housing Finance Corporation (KHFC) was launched. Since their creation, the MCs have continuously broadened their range of activities, with regard to both underlying assets and the capital market instruments it issues. For example, Cagamas began to securitise credit card receivables in 2003 and SME loans in 2007. KHFC started to securitise student loans in 2005. Nevertheless, the credibility of these bond issues with financial markets is ultimately underwritten by the state. Financial innovation in the form of securitisation and the resulting increased interdependence of banking and capital market practices is perhaps the most important change that has occurred with regard to the supply side of capital markets in Asia over the last decade. Again, state involvement in these agencies does not take either a developmental or neoliberal form.

Bond pricing agencies

Institutional developments with regard to the price finding mechanism should also not be disregarded. One important result of the Asian financial crisis was that Asian political economies shifted to 'mark-to-market' accounting of portfolio valuations (see Perry and Nölke 2007 for a critical discussion of this practice). This gave rise to the emergence of an important new set of actors in the East Asian region, the so-called Bond Pricing Agencies (BPAs). While East Asia is not the only region in which these entities exist (there is one in Mexico and another

[4] Perhaps the second most important mortgage corporation in the region is the Hong Kong Mortgage Corporation, incorporated in 1997. However, its analysis would fall outside the remit of this paper as we focus on developments in the AFC-4, Indonesia, Korea, Malaysia and Thailand.

is in the process of being set up in Egypt), it certainly is the region where the development of BPAs has progressed furthest and which holds the largest concentration of these agencies. BPAs are an important means for the price finding process in less liquid domestic bond markets. They develop models which help to assign a price to debt securities, especially in cases where little trading occurs and daily quotations are missing.

Table 2: Bond Pricing Agencies – Selected Characteristics

	Indonesia	*South Korea*			*Malaysia*	*Thailand*
Name	**IBPA**	**KIS Pricing**	**KBP**	**NICE Pricing**	**BPAM**	**TBMA**
Date created/licensed	2005/2007	2000	2000	2000	2004/6	1994/2005 (TBC)
Origin	Government-mandated				Initiative of Securities Commission Malaysia	2004 reform initiative of Bond Mkt Development Committee chaired by Finance Minister
Majority shareholder	1/3 each: Indonesian Clearing & Guarantee; Indonesia Stock Exchange; Central Securities Depository Indonesia	KIS	KR	NICE	20% each: RAM; Mainstream & Co	
Staff		~70	~100	~60		
Regional alliances	2008 BPAM (terminated in 2009)	-	2005 Involved in Malaysia's Bond Pricing Developm. Project		Mainstream is partnered with KBP	

Table is work in progress (not all data confirmed yet).
Sources: BMAP; Bondweb Korea; IBPA; KIS Pricing; KOFIA; Mainstream & Co; ThaiBMA

The first East Asian BPAs were created in Korea in 2000. This followed the November 1997 decision to introduce mark-to-market accounting and subsequent efforts to introduce bond valuation systems by the Korean government. Malaysia and Indonesia followed swiftly in this order. Similar network effects as in the cases of NCRAs and mortgage corporations were at play (see table 2 above). The three Korean BPAs are actually spin offs of Korea's biggest three NCRAs and the involvement of the state has been more that of an indirect facilitator. In both Malaysia and Indonesia the government has played a more proactive role. Bondweb Malaysia, later renamed Bond Pricing Agency Malaysia (BPAM), was set up on initiative of the Malaysian Securities Commission in 2004. Nevertheless, in terms of its operations it was heavily influenced by both RAM, Malaysia's first rating agency, and one of Korea's BPAs via Korea-based Mainstream & Co. (and thus indirectly also Korea Ratings). It is thus a clear product of the entrepreneurial state. A similar set up was intended for Indonesia Bond Pricing Agency (IBPA), but in the end cooperation between BPAM and IBPA was called off. Instead, it was supported by the key capital market bodies. In Thailand, bond valuations are provided by the Thai Bond Market Association (TBMA). Again, the government was crucial in bringing about this expansion of the TBMA's role.

In the wake of the Asian financial crisis of 1997-8, governments in the region decided that markets had to become more transparent to create trust in these markets and to confer them with credibility. For this purpose, setting up BPAs was an important institutional device. However, in so doing the idea of the free market, where the price is determined by the intersection of demand and supply, is put aside. By assigning daily 'market prices' to the bonds that they value, often illiquid securities not traded on a daily basis, BPAs, by government *fiat*, turn the price discovery mechanism on its head. Nevertheless, the developmental state model cannot account for this dynamic either. Prices are not gotten deliberately wrong as suggested by Amsden to channel economic activity where the government wants it. Indeed, BPAs are tasked with discovering a bond's 'true' value (or at least to approximate it as closely as possible) to facilitate an efficient, market-based allocation of capital.

What the evolution of BPAs in East Asia suggests is that even on this level, there is not only increased interdependence (contributing to the network effects discussed earlier once the ball got rolling), but deliberate institution-building to further the promotion and development of Asian bond markets. Effectively, there is an increasing amalgamation of (market-driven) regionalisation and (state-driven) regionalism when it comes to the development of Asian bond markets. Economic actors do not seem satisfied with bottom up (laissez faire) regionalisation, but seem to be keen to actively promote increased financial regionalism. Entrepreneurial states act as conduit for this trend.

More broadly, the three major institutional innovations in Asian capital markets that were introduced within the last two and a half decades, credit rating agencies, mortgage corporations and bond pricing agencies, at least during the early period of their existence are better characterised as quasi-public organisations than as straightforward market mechanisms. The state maintained an important gatekeeper function, serving as conduit, or rather transmitter, of the creation, absorption and ultimately institutionalisation of market knowledge in the domestic financial system.

Conclusion: Why bond market development matters

Over the last few decades, a major feature of Western economic systems was the relative increase in importance of short term profit maximisation vis-à-vis long term investment. Progressive financial disintermediation fosters the displacement of a diachronic logic of investment, where financial activity is linked to investment in productive assets, by a synchronic investment logic 'concerned with the short term and with the profits that can be accumulated in financial markets' (Sinclair 2005, pp. 58-9). This situation is exacerbated by a short term mentality caused by the incentive structure in the financial industry. It is evidenced for example by the performance-linked - that is in terms of short term financial targets - compensation of fund managers, which contributes to reshaping the time preferences of market practitioners (Harmes 1998).

Moreover, variations in investment culture that can be observed in different types of financial systems are linked to risk behaviour. In a bank-intermediated financial system, the bank takes on lending risk on the investors' (or perhaps rather depositors') behalf. To minimise this risk, banks screen and monitor the loans they extend. In a disintermediated system of market finance, complex lending decisions are by and large reduced to judgements about the creditworthiness of the borrower; hence, the importance of credit agencies. As a consequence, disintermediated systems of market finance are underpinned by a 'debt repayment norm', 'in that placing a priority on repaying debt is morally right and obligatory', independent of economic success and viability (Sinclair 2005, p. 66). The expansion of bond finance further entrenches a change in the perception of debt in favour of seeing it as a legitimate source of profit that in turn has entailed a more fundamental shift in financial culture. Moreover, it leads to new borrowing patterns as corporations more and more seek to finance themselves in the capital market, while bank lending is increasingly targeted at households (Ertürk and Solari 2007).

Securities markets allow for the separation between investment (capital) and risk. Only limited control exists once funds are disbursed. As a consequence, efforts to mitigate risk become disproportionately important. This further transforms the normative underpinnings of creditor-debtor relations. While the financing of economic activity is at the core in a bank-based financial system, in a securitised economy it is the management of risk. To transfer credit risk, financial products are becoming more and more abstract (Lordon 2007). However, this perceived ability to sell on risk, at least until very recently, actually increased lenders appetite to take on risk and contributed to the financial bubble prior to the global credit crunch (CGFS 2003). In so doing, bond finance, and the technologies of securitisation that it enables, encourages not only a risk-, but also a debt culture. Overlending tends to become more of a problem as frequently evidenced with regard to the securitisation of mortgages and of credit card receivables (Langley 2008 and 2006; Montgomerie 2006). And this is happening in Asia too (see e.g. Rethel 2012). Securitisation increases the availability of credit, but also contributes to individual indebtedness which makes the issue of a responsible lending culture very pertinent. The importance of finance for everyday individual life has never been so high.

The market mechanism is characterised by allocation through price, not plan. Yet, how does one find the price of what Polanyi calls a 'fictitious commodity', that is capital, and here bonds in particular? In contrast to tangible goods markets, in capital markets future cash streams are traded. Prices thus depend on credibility and transparency, but most of all on trust (Pixley 2002). Again, the entrepreneurial state plays a constitutive role in this regard and efforts to increase the transparency of the capital market by instituting bond pricing agencies have to be interpreted accordingly.

In terms of how the concept of the entrepreneurial state can be developed further, we think more attention should be paid to how within the remits of the entrepreneurial state specific policy knowledge is created (e.g. through mechanisms of innovation, emulation and/or adaptation), how it recombines with other forms of knowledge (e.g. through processes of internationalisation, diffusion and/or socialisation) and how it translates into institutional change. Indeed, there is a broad consensus between state and market players when it comes to the perceived necessity and benefits of the promotion of Asian bond markets. Nevertheless, national variations in the shape of the entrepreneurial state exist when it comes to development of domestic local currency bond markets: for example, the process has been predominantly state-driven in Malaysia, financial market-driven in Thailand and corporate-driven in South Korea (cf. Rethel 2010). For the case of Indonesia, external influences such as in particular financial system development policies as advocated by (consultants from) the IMF and World Bank should also not be ignored (Hamilton-Hart 2006). Nevertheless, in all these countries, states actively encourage the development of bond markets.

Progressive financial disintermediation, especially the expansion of bond finance, has significantly affected financial culture and induced a wide range of behavioural changes with regard to both state and market actors. In so doing, its socio-economic implications are pervasive, ranging from the emergence of a new politics of debt to a decisive shift in individual financial habits. However, changing credit practices, which were underwritten (please excuse the pun) by entrepreneurial states have in turn been a necessary condition for the transformation of bank-intermediated financial systems into disintermediated systems of market finance, which has contributed to the consolidation of the entrepreneurial state model.

URLs

AsianBondsOnline, http://asianbondsonline.adb.org/
Bond Pricing Agency Malaysia, http://www.bpam.com.my/
Cagamas, http://www.cagamas.com.my/
Hong Kong Mortgage Corporation, http://www.hkmc.com.hk/eng/index.html
Indonesia Bond Pricing Agency, http://www.ibpa.co.id/
Indonesian Secondary Mortgage Corporation, http://www.smf-indonesia.co.id/
Korea BondWeb, http://www.bondweb.co.kr/
KBP, http://www.koreaap.com/eng/
KIS Pricing, http://www.bond.co.kr/eng/
Korea Housing Finance Corporation, http://www.hf.go.kr/hfp/eng/
Korea Ratings, http://www.korearatings.com/eng/Inf_eng_004.jsp
Thai Bond Market Association, http://www.thaibma.or.th/
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