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# 15

# Floor Discussion of "Asia: A New Agenda of Financial Reform and Regional Cooperation"

## The Park Paper

Age Bakker of the central bank of the Netherlands, wondered what problem Yung Chul Park was addressing in his paper. "The paper has lots of statistics, but I lack a definition of the problem," he said. "What exactly is the problem for Asia? Is the problem that exchange rate movements vis-à-vis the dollar are not the same? Is the problem that exchange rate movements hamper regional trade integration? Is the problem that you are not able to define your own monetary policy? It is not clear to me what the starting point is of the discussion."

Bakker added that in Europe, monetary integration was motivated by the fact that trade integration was indeed hampered by intra-regional exchange rate fluctuations. But in the case of Asia, regional trade integration seemed to be moving very well. So if Professor Park saw the challenge as one of regional financial integration, Bakker was afraid he was choosing the wrong road. "Regional financial integration is not going to help Asia, because financial integration, by definition, is a global phenomenon. Capital is fungible, it can flow anywhere, and in Europe we have never opted for first having European financial integration and then opening up to the outside world, because according to our analysis, that is an impossible route. There will always be escape routes."

A second point raised by Bakker was the purpose of the Chiang



*From: Financial Stability and Growth in Emerging Economies*
*FONDAD, September 2003, www.fondad.org*

Mai Initiative and whether the envisaged reserve funds would be large enough. "With regard to the reserve funds, the European experience shows that you need to have a very clear purpose before it will do anything tangible. An Asian Monetary Fund is not going to impress the financial markets if it is unclear what it is trying to achieve. If it is trying to achieve stabilisation of Asian currencies vis-à-vis the dollar, then you will need tremendous funds. But if its purpose is to help regional countries that will be hit by contagion and by financial crisis, then you first need to define what sort of exchange rate relations you would like to have among yourselves. There, the European experience shows that a starting point would be to agree politically that your bilateral exchange rates are a matter of mutual interest. Now, for that you don't need statistics. What you need is political willingness. You might even need a hub, for instance Japan."

Eisuke Sakakibara, former vice minister of Finance of Japan, suggested that Yung Chul Park's view reflected a nationalistic and xenophobic backlash against foreign investment banks all over Asia. "We had this backlash in Japan as well," he said. "Several American investment banks received harsh penalties for minor violations of the law. But basically this is a reflection of the sense of insecurity and the sense of vulnerability of the Asian countries. I am not surprised by the statistics that Yung Chul has given us. This hub-and-spoke relationship has existed between Asia and the United States for decades. Look at the national security arrangement between the US and Japan, this is also a hub-and-spoke arrangement. It is the nature of the Asian economies, being dependent on the US. This strong relationship between the US interest rates and money supply and our domestic interest rates and money supply is not surprising. Even after floating, we continue to manage our exchange rates vis-à-vis the dollar. There is no market between the Korean won and the Japanese yen, there is only a yen/dollar market and a won/dollar market, and we have managed those floats through intervention vis-à-vis the dollar. However, it is important to realise that after the East Asian crisis in 1997, Asia has become aware of its heavy dependence on the US and that it may give rise to increasing vulnerability of the countries in the region because it is an inherently unstable relationship. This is why the fever for regional cooperation has intensified after 1997. After the crisis people came to recognise this very heavy dependence on all fronts on the US."

Sakakibara told of an experience on an Advisory Board which was chaired by Henry Kissinger. “When I started to talk about ASEAN+3 and regional economic cooperation among China, Korea and Japan, Kissinger jumped and said: ‘Sakakibara, are you choosing China over the US? Then we have to rearrange all of the things we have agreed on in our security relationship with you and the rest of Asia’. That’s the very typical American perception, a hub-and-spoke relationship in all fronts with Asian countries. My perception is that time has come to gradually change that relationship vis-à-vis the US. Maybe it is still too early to create a won/yen market, but we can at least coordinate our intervention efforts or our management of the floating rate vis-à-vis the dollar between Korea and Japan.”

Marek Dabrowski, a former vice minister of Finance of Poland, said that Park and Sakakibara were not talking about an exclusive Asian problem. “All financial transactions are, in fact, going through a very small number of global financial centres. It is the same in Eastern Europe and in Europe in general, where most of the transactions are going through London and New York. This is the natural organisation of financial markets. For technical reasons, this market is much more centralised than the markets of goods or services. We must live with it.”

Dabrowski stressed that, if Asians were thinking about building a new regional currency, one of the key questions was whether it could sustain competition with currencies like the dollar and the euro. Another key question was, in his view, that “in order to build any kind of regional currency you must have a minimal political commitment and some supranational political institution. If you take the political decision to build a monetary union, this helps to eliminate asymmetric shocks, synchronise business cycles and promote trade and capital flows inside the future common currency area. Political readiness to run common monetary policies is very important. I don’t know of any historical experience where a monetary union could be sustained without political commitment.”

Zdeněk Drábek, of the WTO, also wondered what problem Park was discussing in his paper. “The one interesting answer that I was trying to give to myself,” he said, “is that there must be a big difference between integrating trade as opposed to integrating financial institutions. I am very encouraged to see that the Asians are integrating on the trade level. At the same time, I am not surprised at all that the financial integration is not taking place as you would like to think. But I would like to pursue the question further and go beyond the variance analysis. If you ask, what really are the impediments to the fact that the syndicated loans are not run by Japanese banks or Thai banks, you will find interesting answers. Maybe it is the fact that there are five investment banks that dominate the capital markets, or the fact that there are three major world currencies. Those are the major issues, but at the same time I ask myself if it really matters. Ten years ago we were all worried that we were going to be taken up by Japanese banks. How quickly things can change. So I would not worry so much about the fact that regional financial integration has not proceeded as fast as you would have wished."

Rogério Studart, of ECLAC, thought that the problem of financial globalisation was not so much a question of ownership of capital, nor the oligopolistic characteristic of it, but the clash of institutional settings. "Every country has developed a certain type of financial institution that was functional to the process of development. For many years in East Asia, the banks were machines for financing investment and trade. In the 1990s, this institutional setting lost a little bit of its functionality with financial deregulation when the existing institutions began failing for competitive reasons or for other reasons. This led to a situation where the institutional setting that was once functional, began to disintegrate. What I see in the 1990s in East Asia is that the problem was no so much financial integration but the fact that financial deregulation destroyed some of the institutional settings that had been created within the financial system to finance investment and trade and nothing was put there to replace them."

Stephany Griffith-Jones, of the Institute of Development Studies, thought that she understood very well what problem Yung Chul Park was trying to solve through Asian monetary cooperation, namely the serious problem of the vulnerability of developing countries to large international capital flows. "But what I don't really understand," she said, "is why the Asians just don't go ahead with monetary cooperation, because as Yung Chul has pointed out so clearly in previous Fondad meetings, the reserves that are available in the Asian countries are very large, more than 1000 billions dollars."

Griffith-Jones also wondered why the Asians should worry about security arrangements with the United States. "If the Americans had said the same things to the Europeans, as Kissinger has said to Sakakibara, I don't think the Europeans would have worried so much about it."

Charles Wyplosz followed up on Sakakibara's comment that Park's paper was about nationalism and pointed to the importance of political movements. "I suspect that in Argentina after the crisis there might also be a rise of nationalism," he said.

"Anybody who knows what nationalism is, would not say that," Yung Chul Park retorted. "You are turning my paper into a paper about nationalism..."

"That is not what I am saying," Wyplosz replied, "I am saying that nationalism is playing a role and that this is something we should be concerned about because we are talking about multilateralism and financial integration. For us, as economists, financial integration makes a lot of sense, it is about efficiency and so on, but if the people down in the street see it as foreign interference, then the whole thing would collapse. We already went through the opening up and closing down of the international financial system once (in the first half of 20$^{th}$ century), under deep political pressure, and that's why I became scared by Eisuke Sakakibara's interpretation. I see that Yung Chul doesn't like this interpretation, but he should not complain to me but to Eisuke."

Wouter Raab, of the Dutch Ministry of Finance, did not like the term nationalism and moved the discussion in another direction. "Part of the answer to Yung Chul Park's question of why liberalisation of financial markets has not automatically led to integration of financial markets, is that you need an awful lot of regulation and an awful lot of harmonisation before that takes place. Financial integration does not follow automatically by opening up, you need to do a lot of hard work. This is even more so than in the case of trade, because even when there are numerous non-trade barriers, you can still ship goods from one country to the other. But in the financial sector, to give you an example from the Netherlands, you are not allowed to offer any financial products to, for instance, Germany. There are still a lot of barriers that have to be broken down."

In his reply to the comments, Yung Chul Park expressed amazement that so many people suggested that the problem he addressed in his paper was unclear. "I am trying to write a scientific paper. It has nothing to do with politics, with nationalism or anything else. That is the last thing I have in mind. If you read some of the recent papers by Andrew Rose and his associates, the empirical evidence is clear that the formation of a currency union among a number of countries leads to a substantial increases in trade, and that it is a welfare gaining activity. There is no doubt about it. Second, the formation of a currency union is not a stumbling block, but a building block for global integration. My point is that in East Asia, 13countries have been working together to establish a regional financial arrangement with the long-term objective of creating its own currency, and this objective has nothing to do with nationalism or anything else. If you look at the trade side, you see that the 13countries are clearly moving toward a currency union. Within 5 or 10 years the 13 countries will be able to agree on monetary integration if you only look at the trade side, and there will be a lot of gains to be made by fixing their exchange rates or creating their own currency."

Park mentioned some of these gains by recalling the "crazy fact" that the 13 countries of East Asia are running a financial surplus and are financing deficits of the rest of the world, including the US, while none of these Asian countries, except Japan, has been able to borrow from international financial markets in their own currencies. "If you create your own currency and currency union, then securities denominated in regional currencies will automatically spring up. And if these countries can establish regional financial markets, then regional financial markets may be able to finance more of investment in East Asia."

Park concluded: "As for the definition of the problem, I have many definitional problems, but let us not forget that economics is a definitional problem to begin with. I don't understand how what I am saying can be interpreted as nationalistic. I am not against financial globalisation, I am saying that we can have financial globalisation and, at the same time, regional financial integration. These two can go together. In Europe, you have Europe-based financial markets and Europe-based financial integration and that is not inconsistent with globalisation."

## The Sakakibara Paper

In the discussion on Sakakibara's paper, Yung Chul Park returned to the criticism of Europeans to Asia's efforts at regional financial cooperation. "Why is the formation of a regional arrangement in East Asia receiving such a hostile reception from Europeans, who worked for many years to come to where they are now?" wondered Park. "I would think that the European Union would be supporting an East Asian regional arrangement more than any other country or grouping of the world. But that is not the case. And why is Europe so anxious to expand its territory (to the east) and its influence at the same time?"

Following up on Sakakibara's paper, Park addressed the question of whether the Chiang Mai Initiative or the bilateral swap arrangements were going to be a substitute or a complement to global arrangements from institutions like the IMF. "It should obviously be a substitute," he said. "After the East Asian crisis, most of the crises are going to be current account crises and what you need in such crises is immediate, large amounts of liquidity without any conditions. You can worry about conditionality later. In the case of Korea, it took 10 days to agree to the IMF conditionality. But if there are any symptoms of a currency crisis, you need an immediate supply of a large amount of liquidity and this can only be provided at the regional level. Even though East Asia is not one of the richest regions in terms of living standards, it is one of the richest regions in terms of savings with more than 1 trillion dollars in reserves. Isn't it a crime that we are lending these dollars to the US? We could lend it for better purposes, we could lend it to Africa, to Latin America maybe even to Central Europe."

José Antonio Ocampo, of ECLAC, stressed that regional institutions should not only be complementary but also competitive to global institutions. "There are three arguments for competition. The first one is what I have called the federalist argument – a heterogeneous community will not always want to have an all powerful central power. This is why Europe would never have allowed the crisis of the EMS to be managed by the International Monetary Fund. The second argument has to do with the problem of control over the global institutions. Global institutions are not democratic. Since there are specific interests behind the world institutions, it is good to have competition. A third argument relates to small players. Small players always like competition, that is the traditional neo-classical argument. So why not have competition in the supply of financial safety nets? If a small country like Honduras goes into a crisis, it is better off with three or four alternative institutions supplying it with financial support rather than one."

Charles Wyplosz supported José Antonio Ocampo's plea for competition by regional institutions, and gave an additional argument. "The IMF, like any institution, is bound to make mistakes in its analysis, but when the IMF makes mistakes, it doesn't pay the price and the costs can be huge for the countries that have to go through their conditions. A good reason for competition by regional institutions is that it would increase the competition for ideas. So when the IMF says: 'We think Korea should do this' or 'Argentina should do that', a competing Fund could say: 'No, this is wrong', and a healthy debate will be triggered. However, in a crisis situation you can't discuss too long."

Roy Culpeper, of the North-South Institute, thought that both Eisuke Sakakibara and Yung Chul Park (as well as José Antonio Ocampo and Stephany Griffith-Jones) had clearly demonstrated the weaknesses of the global financial system as well as the rationale for regional solutions. "I see the strengthening of regional cooperation as a strategy for trying to remedy what the global architecture has been unable to do. Since 1997, we have seen discussions about collective actions clauses, about debt standstills, and recently there was a glimmer of hope with the debt work-out arrangements that Anne Krueger put on the table in the IMF. But all of these proposals have been on hold and this has contributed to a sense of frustration both in Latin America as well as in Asia. Let's be honest about it: it is global real-politik that determines how global institutions work. And if regions of the world want a financial architecture that really does look after their interests, they have to look to a regional solution."

Culpeper went back to the question of what one really gains with financial and capital market liberalisation and said that the answer was not yet clear. "Amar Bhattacharya gave some numbers for the gains of trade liberalisation, but even on the cause of the relationship between trade openness and economic growth, the jury is still out. But the jury is certainly out on issues of financial sector liberalisation. All of the evidence and analyses that I have seen suggest that the gains from financial sector liberalisation and capital account opening are very questionable, perhaps even negative.

I am reminded of some work that Martin Feldstein and Charles Horioka did over a decade ago, which pointed to high correlations between domestic savings and investment. They were actually talking about how little the world capital market was integrated and this is reinforced in large part by the work of people like Dani Rodrik who argued that, if you are concerned about growth and development and poverty reduction, basically what you have to do is increase your savings rate and your domestic investment. That is what it is all about."

Heiner Flassbeck, of UNCTAD, thought that Roy Culpeper stated it too simply. "I agree that there are a lot of disputable assumptions in the theory that opening everything would be the best for the world, but to go to the other extreme and say, 'Don't care about capital markets and just promote your savings and investment', is too simple because what will happen is that countries will not stop trading but will start having trade wars and the like. You will have shocks of huge dimensions coming from devaluation, which is the best instrument you have to promote exports, and from subsidies and other instruments you have to promote exports such as lowering taxes. We need solutions for some problems, we have to try to find common rules for certain kinds of interventions by governments in the market. Saying that you can just rely on your national powers and abilities, is going a step too far."

In his reply, Eisuke Sakakibara stressed that one of the major motivations for the creation of an institution like the Asian Monetary Fund is that the globalising financial market is inheritably unstable without a global lender of last resort and without a global regulator. "In Asia," he said, "the idea is: If we are accumulating 1 trillion dollars of reserves, why not pool the reserves regionally and create a regional lender of last resort? Let's pool half of it and come up with a joint strategy in terms of crisis management and stabilisation of exchange rates."

Sakakibara warned that if financial markets are fully liberalised without having a lender of last resort and global regulator, the world is left with a completely unstable financial system. "The crises will hit us over and over again as globalisation proceeds. If the IMF could play the function of a lender of last resort to some extent, it would be a different story, but it has proven that it cannot do that nor does it have the political mandate to do that. We have gone through all kinds of discussions on the international financial architecture, I myself have been involved in the discussions and I respect the efforts that have been made, but not much has ever come from it.

We need competition to reform international financial institutions. I am not against financial integration or financial liberalisation. You should let the market proceed, provided that we have some public mechanism of lender of last resort and regulation, provided that competition policy is imposed in those institutions, and provided that conflicts of interest of accounting firms, rating agencies and so on be pointed out and that these firms are regularly inspected. Let the public institutions develop either globally or regionally to stabilise inherently unstable global financial institutions.

What we try to promote in Asia is horizontal networking. Japan has no intention of becoming a hub in Asia, we can't, we don't have the capacity nor the attitude to be a hub in Asia – if anything China could be hub. One of my favourite jokes these days is that within 10 to 20 years, Japan may become the 51st state of the US or the far East province of China. What we need is networking and horizontal cooperation, not hierarchy.

The time for G-7 is over. Europe has now been integrated into one unity. There is no reason to have Italians, French and Germans separately in the G-7, you should have one European country. Other fora are needed that include Europe, the US, China and India along with Japan and Russia.

We need a completely different type of organisation, we need an international negotiating forum. I have participated in G-7 processes for about a decade but the effectiveness of G-7 has declined throughout this period. The effectiveness of – and I'm sorry to say this – the IMF and the World Bank has also declined throughout this decade. So some other international financial and development infrastructure is now required."