Keynote Speech
ASEM Conference
Shilla Hotel, Jeju, June 15, 2008

Regional Cooperation Towards Global Financial Stability

Dr. Il SaKong
Special Economic Adviser to the President
Chairman, Presidential Council on National Competitiveness

Introduction

Minister Lagarde,
Distinguished guests,
Ladies and gentlemen,

Let me first of all thank the organizers of this conference, the Ministry of Strategy and Finance of Korea, the Ministry of Finance of Slovenia and the European Commission, for inviting me.

It is a great privilege for me to speak before this distinguished audience.

The 8th ASEM Finance Ministers' Meeting and this ASEM Conference cannot be more timely as the global economy is going through a financially stressful period which began with the US subprime mortgage debacle.

It is obvious that to help prevent and remedy such a financial turmoil, serious efforts have to be made for improving financial regulation and supervisory infrastructure at the national level. At the same time, considering a rapid pace of globalization, global community level actions for reforming the current international financial architecture are also required to make it suitable to the changed global financial environment. In addition, regional level policy and institutionalized cooperative arrangements could be made to supplement the international financial architecture.

It is my sincere hope that useful policy recommendations and action programs with respect to all three levels – national, regional and global – will emerge out of these meetings.

The 1997-98 Asian Financial Crisis and the East Asian Economic Cooperation

Unlike Europe, East Asia as a region did not have serious institutionalized efforts to integrate economies in the region with the exception of the ASEAN process for the Southeast Asian countries until the Asian financial crisis.

However, the crisis woke up the countries in the region, including three Northeast Asian countries – Korea, China and Japan – to realize the fact that the economic and financial cooperation among neighboring economies are important in facing new challenges posed by the globalization.

Since the crisis, numerous initiatives of bilateral or plurilateral FTAs have been launched among themselves and with economies outside the region. Even China-Korea-Japan decided to take up a feasibility study of three-nation FTA. Furthermore, Korea-Japan started negotiations for an FTA between the two countries, albeit currently stalled. However, a whole East Asian region-wide FTA has not been seriously discussed as yet.

On the financial side, a region-wide cooperative mechanism, now known as the Chiang Mai Initiative (CMI), was introduced within the framework of the ASEAN+3 process with Korea, China and Japan's active participation together with the ASEAN.

As you know very well, the ASEAN+3 finance ministers agreed to set up the CMI, which was a network of bilateral currency swap arrangements, in Chiang Mai, Thailand in 2000 following the ASEAN+3 summit in November 1999.

Since then the CMI has made a significant progress in terms of its size and *modus operandi*. It is now evolved into an $80 billion multilateralized currency swap scheme as a self-managed reserve pooling arrangement.

I have personally advocated for some time now to let the CMI evolve into a full-fledged regional monetary facility by first expanding and multilateralizing currency swap arrangements. Obviously, therefore, I welcomed the ASEAN+3 finance ministers' agreement made in Madrid in May to expand the reserve pool with the vision of making it a full-scale Asian monetary fund.

As a regional monetary facility, its surveillance and early warning function should be strengthened to help prevent future financial crises although the CMI was originally set up as a defensive reserve pooling arrangement. Through this facility, closer macroeconomic policy coordination could be achieved for maintaining stable exchange rates among major currencies of the region.

In this regard, I also welcomed the finance ministers' Madrid decision to strengthen the current Economic Review and Policy Dialogue (ERPD) by increasing the frequency of the dialogues and developing a standardized format for the provision of relevant information and data.

Another important development towards the regional financial stability is the Asian Bond Markets Initiative (ABMI) which was designed to build efficient and liquid bond markets in Asia for minimizing the risk of currency mismatches. The Asian bond markets have already recorded a remarkable growth in its size and diversity of issuers during last five years. I am very sure that the ABMI with the new ABMI Roadmap endorsed by the ASEAN+3 finance ministers in Madrid will definitely become a significant contributing factor in ensuring the regional financial stability in coming years.

At this juncture, I must say that the progress toward the regional financial stability made so far is quite laudable. Going forward, I would like to suggest, if I may, establishing a “financial research and training institute” which would carry out research for the regional financial stability, engage in training financial managers, supervisors, regulators, credit analysts, etc., and facilitate dialogues among policymakers of the region to share their valuable experiences of both successes and failures. Perhaps this institute could be incorporated into the CMI when it becomes a full-fledged regional monetary facility.

It is my firm belief that the East Asian initiatives for closer financial cooperation will definitely help maintain both regional and global financial stability in coming years.

Having said this, I must stress the importance of mutual trust and respect among peoples of the region as a foundation for a deeper regional integration through closer economic cooperation and policy coordination. It is particularly true in the case of three Northeast Asian countries. Any policy coordination among neighboring countries presupposes that they are willing to sacrifice domestic policy autonomy to some extent, and to accept “peer pressure” from their neighbors. Unless there is a strong sense of community based on mutual trust and respect, even well-intended peer pressure can be misinterpreted and unfavorably politicized.

Reform of the International Financial Architecture

The Asian financial crisis of 1997-98 gave an impetus to the discussion of reforming the international financial architecture (IFA). Major issue areas of the discussion included foreign exchange rate regimes, short-term capital flows and highly leveraged financial institutions, private sector involvement (PSI), international financial institutions, and international codes and standards.

Without getting into details, I suppose one can say that a substantial progress has been made in each of these issue areas to help improve the IFA. However, some of the major recommendations put forward by eminent private expert groups, i.e., the Meltzer Report (1999), the Council on Foreign Relations' Report (1999 & 2000), and the Emerging Market Eminent Persons Group Report (2001), are not fully reflected in the IFA reform as yet. They include major issues of foreign exchange rate regimes, short-term capital flows and highly leveraged financial institutions, and the PSI.

The ongoing subprime mortgage lending-caused global financial turmoil again brings us back to the IFA reform issues. Of course, there are measures to be taken at the country level to improve the national system of financial regulation and supervision. As you know, the US government has already put out a financial regulatory reform package for public discussion.

I am certain that similar credit crises with cross-border dimensions can occur in the future. Therefore, it is important for the global community as a whole to make efforts for reforming the existing IFA to help prevent and resolve such crises. As you know, there are already a number of specific recommendations made in this regard. They include the measures to strengthen the Financial Stability Forum, to make the Basel Committee more representative and to enhance surveillance for hedge funds and private equity funds. I just hope that these measures will be seriously considered for adoption.

It is needless to say that regional level endeavors are also desirable. For example, a common upgraded standard of financial regulation and supervision could be introduced at the regional level.

I believe that the ASEM as an inter-regional cooperative process can certainly contribute in this regard. The AESM Vision Group (1999), for which I had the privilege of chairing, did emphasize "a need for Asia and Europe to achieve a coordinated response matching rapid financial globalization."

A Concluding Note

The global economy for its continued prosperity needs an adequate supply of a public good, that is, global financial stability by improving the IFA. To this end, it takes a strong global leadership. Currently, however, it seems to me that the necessary leadership is not forthcoming.

Therefore, to supplement the public good supply gap, closer cooperation for financial stability is much desired. For this reason, the global community should encourage rather than discourage regional institutionalized financial cooperation. This, in turn, would contribute to the global financial stability, provided its mode of operation is consistent with operating principles of the international financial institutions. I think it is, therefore, a good idea to have closer consultations with them in the process of institutionalization.

I would like to end my remark this morning with the hope that the 8th ASEM Finance Ministers' Meeting will assume the leadership in reforming not only the regional level financial architecture but the global financial architecture.

Thank you for your attention.