

GENERAL DISCUSSION
Asian Regional Policy Coordination

Chair: Barry Eichengreen

Mr. Eichengreen: I want to ask about the obvious disagreement between the two speakers in this session about the question of speaking the truth to power. It is relevant to the scope of surveillance in the region. Long-time observers of the region talk about the ASEAN way, which is the tradition of non-interference in neighbor's affairs and not criticizing the policies of other countries in the region. Is the ASEAN way still the way of the region? Is there still a reluctance to interfere, and if so, is it a serious obstacle to the kind of firm surveillance that would be required for real reserve pooling and policy coordination?

Mr. Truman: In the paper I talk about two particular cases that you might think about as following the ASEAN way. One is Vietnam, which has real problems at the moment. The question I raise is, to what extent have the informal processes and coordination that exist within Asia—ASEAN and broader—addressed that problem? It would appear from the outside that the principle influence over Vietnam's policies over the last several years came from the traditional source of the IMF, notwithstanding the fact that Vietnam actually has a somewhat stand-off view of the Fund on the financial side. The other case, which is even more interesting and which may cut the other way, is Indonesia. The executive board and staff of the Fund thought the Bank of Indonesia should be ready to raise interest rates because inflation was a problem, and since then they've lowered interest rates by 75 basis points. So this shows the conflict within the region. My sense is, and I think the Europeans would agree, that starting in the 1970s, Europe increasingly took surveillance into their own hands, and both surveillance and financing were provided within the European context. It worked for three decades, but in the end the outside had to come in, with surveillance and programs and financing. So it is very difficult for neighbors to speak truth even when it's not a question of power. That's one advantage of having outside voices. But my colleague from Hong Kong probably knows more about this than I do. I'm only an outside observer.

Mr. He: In my personal experience with the EMEAP (Executive Meeting of East Asia-Pacific Central Banks) surveillance process, there are usually frank

discussions among the senior officials of the central banks. In fact, if you read the monetary reports of EMEAP central banks—of course they're not public documents—they usually are more blunt than the assessments by international financial institutions such as the IMF. These reports focus mostly on regional issues and common vulnerabilities in the region. But I do agree with Ted that, in the case of individual members of ASEAN such as Vietnam, outside analysis by the IMF is essential. That's why I have continued to emphasize that independent surveillance by international financial institutions is still very important for regional coordination.

Mr. Aizenman: I enjoyed listening to Ted's presentation. If I followed, you're equating the integration in Asia to that in Europe. My reading is that Europe is now closer to being a zero contributor to global imbalances. This contrasts with Asia, which you mentioned has a current account surplus of \$550 billion with the rest of the world. This is a significant figure, particularly when the global economy is facing recessionary pressures and is looking for more demand for world output to come from Asia. This leads to another point, that there's a tendency to focus too much on exchange rates. I think the current tension over appropriate exchange rate levels may be related to concerns that some countries are seeking to subsidize the cost of capital or are not sufficiently protecting intellectual property rights. I'm aware that these factors may not be the appropriate focus of a Fed conference. But at times of recessionary pressure and unemployment in the United States exceeding 9 percent, such real-side factors may dominate future discussions of global coordination as much as or maybe more than exchange rate economics.

Mr. Truman: Two points. First, I was using the figures about the global imbalances to talk about whether capital is flowing north or south, so I was trying to make an analytical point more than assessing Asia's contribution to global imbalances. That relates to your question about exchange rates and comments on my paper. Second, no offense to Shang-Jin's work, but I do think nominal exchange rates have something to do with the story. I've lived long enough to have gone through this before. We debated in the 1960s and 1970s whether nominal exchange rates were a contributing factor to the small imbalances of that period. I think the vast evidence proves that nominal exchange rates do matter. They're not the only factor—they can be wiped out, for example by inflation on the depreciation side or deflation on the appreciation side. But nominal exchange rates are a very efficient means of changing the price between traded and nontraded goods, and that is part of the adjustment process both in the countries that are depreciating and those that are appreciating. Some of it will

be offset, but the overwhelming evidence suggests that exchange rates matter. Even in the case of China, there are many papers that show things that are different from Shang-Jin's. For example, my colleague Bill Cline has a paper that shows very convincingly that exchange rates matter.

Mr. Eichengreen: In the interest of continuity, I'll turn to Shang-Jin.

Mr. Wei: I reiterate my view that beyond a reasonable horizon the nominal exchange rates may not play much of a role for real exchange rate adjustment. I want to turn to a different point. There's a lot of talk about global imbalances, without really making a distinction that some imbalances are potentially good and others are potentially inefficient. Therefore some imbalances need to be corrected, others do not. For example, efficient trade reforms, such as China World Trade Organization accession, may benefit other countries as well as China itself. These reforms have contributed to the sizable Chinese current account surpluses that we see now. Why? Some people first thought that China's WTO accession meant unilaterally reduced barriers on imports that would lead to a reduction in the current account surplus. However, that's only a partial equilibrium intuition. In general equilibrium, the reforms reduced the price of goods in which China has a comparative disadvantage—capital intensive goods. According to the Stolper-Samuelson effect, this leads to a reduction in returns to capital, and a way for China to restore equilibrium is to export capital by running current account surpluses. In fact, part of China's current account surplus can be attributed to this channel. I estimate that it accounts for about 20 to 30 percent of the surplus. That's efficient; you don't want to do something to block that access. There are obviously inefficient current account imbalances that need correction, but if underlying structural factors are the cause, it's not obvious that the nominal exchange rate is the socially best way to do the adjustment, so that's the point I want to make.

Mr. Spiegel: I'd like to revisit the question of regional cooperation in encouraging the development of local financial markets and in particular bond markets. Prior to the global financial crisis, there was a lot of motivation for the ABMI (Asian Bond Markets Initiative) and the ADF (Asian Development Fund), along the lines of the concept that Asia as a region was overbanked. This was based on comparing Asia with Latin America or various benchmarks. But during the crisis, Asia as a region performed relatively well, partly because of the nature of its financial system. Do the speakers think that these initiatives are now anachronistic, or is there still scope for government intervention in encouraging the

development of local currency bond markets and other regional financial initiatives in the region?

Mr. He: That's a very important question. The idea that bond markets will provide a spare tire, according to Mr. Greenspan, is very popular in policy circles. But I have some doubts about that. I think the financial crisis experience shows that when the banking system doesn't work, bond markets probably would not independently provide a source of finance either. That doesn't mean that these initiatives have disappeared in Asia. The idea is still to encourage diverse forces of financial intermediation. At the moment the ADF funds are not being spent, but there are initiatives to standardize payment and settlement systems. If the markets are small, that's not necessarily a stabilizing force, so there may be rationales for using off-shore markets to swap back into local currencies. But how do you manage the financial stability risks associated with currency mismatches, are these hedging instruments effective, etc.? So I think all these issues are being researched, and whether that calls for policy intervention has also been discussed in various forums. I agree with you, it is very difficult to develop bond markets, particularly ones that are large enough and liquid enough. But I think the development of renminbi markets is very promising because the renminbi is set to become a major currency in the region. There's a lot of regional interest in seeing more bond markets denominated in renminbi.

Mr. Truman: Three points. First, I do have something in my paper on the bond market development question. There are certain advantages related to financial market development, but they're not related so much to how the region relates to the world as a whole. Just developing a better financial market isn't going to reduce current account imbalances. Second, on Mr. He's comments. I'm glad he basically agreed with me and was reassuring on the basic proposition of the paper. Third, I talk in the paper about the responsibility of major countries that issue major international currencies. I don't like talking about issuing reserve currencies, because I think that's a misconstruction. I am an advocate of developing a global swap network, and I outline in the paper a way I think it could be done that might satisfy both the central banks who don't like being bossed around by the IMF and the finance ministries. I think more progress in that direction is appropriate. As long as we're going to have a range of international currencies, potentially the renminbi, there have to be some appropriate safeguards under which liquidity could be supplied by the central banks issuing those currencies when there's a crisis. Thank you.