GENERAL DISCUSSION
Asia and the Global Financial Crisis

Chair: Rakesh Mohan

Mr. Hale: You outlined very clearly what the medium-term goals have to be in terms of current imbalances, which are higher savings here and more consumption in East Asia. I guess the next question is, how do we go about achieving that? These have been goals we've talked about now for several years, even before the crisis, and it looks like we have an intractable deficit problem here in the U.S. at the federal level. And China has taken a lot of dramatic steps over the last two years on every front, including health care, pensions, and education spending. But the household saving rate still remains very, very high.

The second question is on the immediate challenge in the next year of financial stability. Large numbers of emerging market fund managers now believe we're heading for an asset bubble in East Asia. The combination of a weak U.S. dollar, potential exchange rate appreciation in East Asia, and central banks avoiding exchange rate appreciation is going to encourage big gains in foreign exchange reserves, $500 billion already since March, and this will nurture money growth and asset inflation. Is there any way the G-20 countries could address this issue through some new form of policy coordination, maybe encouraging the Asian countries to allow more exchange rate appreciation, for example?

Mr. Bernanke: Thank you. Well, you're right that there's a lot more talk than action about the current account imbalances in the period prior to the crisis. We had the IMF doing some consultations, but domestic policies were only modestly changed in response to that. Now, of course, we've had this terrible crisis. Clearly global imbalances have played some role in this crisis, and we've also had some important changes in global governance. You know, I used to attend one G-20 meeting a year, and now I seem to be attending them every other week. We have, I think, very appropriately and importantly, expanded the community of nations which are looking at these issues to include all the major emerging market nations or the biggest ones in the G-20, which, as you know, has been elevated to the leaders' level, as well as to finance ministers in central banks. And the G-20 communique from the most recent meeting was very clear, and it was signed on to by China and Asian countries as well as by the industrial countries, about the importance of restoring balance and sustainable growth in the global economy. So, I think there is certainly more urgency now than there was, and there's more legitimacy to the governance process that should bring about greater balance.

I think, in the case of the United States, you're right, we have a difficult fiscal situation. But I think our policymakers recognize that we need to develop a fiscal exit strategy which will involve a trajectory towards sustainability. As I described in my remarks, that's critically important in order to maintain confidence in our economy, confidence in our currency, and so on. I know that's very well understood in Washington. By the same token, I believe that the Chinese, and the other Asian countries to a greater extent, are looking more seriously at rebalancing. The five-year plan in China, which now incorporates more social developments and more domestic spending, does appear to be having some effect, although it's very early and, of course, it is difficult to make such large changes. But I do think that we need both sides to participate in this rebalancing process. Now that we have a governance process which is supporting it and is directing the IMF and other international agencies to support that process, I think we have a better chance of getting there. In any case, I believe it's extraordinarily urgent, and I think most people would agree with me.

On asset price bubbles, I understand that's a concern. The Asians have been concerned about it. One way to address it would be through greater exchange rate flexibility, coupled perhaps with offsetting movements in fiscal policy. But clearly it's an issue that the Asians are going to have to pay close attention to as they look at all the different objectives they're trying to reach with their various policy instruments.

Mr. Mohan: Do you have a question?

Mr. Dooley: I think before we put a huge effort into eliminating imbalances, it would be useful to know, and we'll discuss this for the next two days presumably, what the connection was between the imbalances and the crisis we just had. You said they're clearly related, but, at least in my mind, there's no clear mechanism that we can point to and say, ah, there is a link between international imbalances and the crisis we've had. The other link is between insufficient regulation and the crisis. Since we have limited resources for reform, it seems to me we need to establish which of those links is more important before we go too far down the road of reform.

Mr. Bernanke: Well, it's certainly true the relationship between global imbalances and the crisis is a complex one, and I know that the Obstfeld and Rogoff paper later this morning is going to look at some of the complexities in that relationship. But I think we could hardly fail to be struck by what, in retrospect, is the parallel between the global financial crisis we're seeing now and the emerging market crises we saw in the '90s and many other periods. What those crises constituted were large capital inflows into a country and a financial system that, either because of immaturity in the financial structure itself or because of inadequate transparency in regulation, proved unable to manage adequately those inflows. And so, whatever complex story we end up telling about this crisis, clearly part of it was the fact that a lot of capital flowed into the industrial countries. The United States, of course, had a current account deficit of about 6 percent of GDP, corresponding to large capital inflows, which would not be a problem if we had invested and managed that money appropriately. But evidently we were not able to do that. Our financial regulatory system, financial private sector, and risk management mechanisms were overwhelmed and did not do a good job. As a result, there's a close interaction, I think, between capital inflows and the financial regulatory system. So, personally, I think you're going to have to address both of them, conceding that there are many complex interactions going on. But, to me, I think, there's a clear parallel to literally dozens of crises that we've seen previously. We were too smug. We saw this happening in emerging markets. We said it wouldn't happen in the United States, but a very similar pattern existed here as existed in other countries.

Mr. Mohan: Last question, Barry?

Mr. Eichengreen: After the Asia crisis, many countries concluded that they need more reserves, that they need more insurance in one form or another from shocks. And that creates a tension with the desire we all feel for global rebalancing. So the question is, do you see other mechanisms through which they could obtain the insurance they need?

Mr. Bernanke: Well, the motivations for accumulating foreign reserves are complex. In some cases, you have countries that have reserves that exceed all of their external debt, and so it's not clear that the reserves are simply there to address potential financial crises. They're also there as the byproduct of various policies relating to global imbalances in trade. So, I think that if we address the issues relating to global imbalances, to some extent problems with reserves will be addressed as well. Now, your question is alluding to alternative insurance mechanisms, and many people have talked about various ways of getting away from self insurance to mutual insurance or other kinds of systems. I know that over the next decades there will be a lot of talk about ways of economizing on reserves. But again, I think that in the near term, the best way to address the issue of reserves is to address the fundamental cause, which is the imbalances generating those reserve accumulations. Thank you.

Mr. Mohan: Thank you very much.