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“Ten Years After the Asian Currency Crisis: Future Challenges for Asian Economies and Financial Markets”

1. Thank you very much for inviting me to be with you today. This is a day for looking forward, but as we consider the challenges that Asia will face in the coming years, it is worth briefly looking back at the challenges that Asia has already confronted. Ten years ago, major emerging economies were hit by a currency crisis triggered by capital outflows of a scale and rapidity that had not been seen before anywhere in the world. The crisis revealed unsuspected flaws in the banking and corporate sectors, and did great damage. But Asian countries overcame the crisis. I am proud that the international community, acting through the Fund, stood shoulder to shoulder with Asian countries throughout it. The international community provided financial support when the private sector was running for the exits. The Fund was the catalyst for this support, including strong support by our hosts today, Japan. The success of the policies adopted by Asian countries and supported by the Fund can be seen in where Asia is today: the most dynamic region in the world.

2. As Asia and the Fund consider future challenges, we can draw on some lessons learned over the past 10 years:

- We have learned to guard against the consequences of capital market disruptions. In the last decade, the global integration of capital markets has become even deeper. As a result, both the benefits of free trade and free capital flows and the risks associated with volatile capital movements have increased. But Asian countries and the Fund are also now better equipped to deal with these risks. Many countries have moved to flexible exchange rates, and strengthened macroeconomic policy frameworks. Some have built up reserves as a first line of defense against crises. Asian countries working together have established mechanisms such as the Chiang Mai Initiative to give further support. We believe that this approach is very useful, and are happy to be engaged with it. For our part, the Fund has introduced new instruments and increased the financial resources that it can make available to help all our members deal with future crises. We also give greater weight in our policy advice to the risks associated with capital movements.

- We have learned that shocks in the financial sector can spread quickly to other sectors, and that the interlinkages between sectors must be taken into account. In Asia this understanding has led to impressive efforts to reform financial sectors, overhaul regulatory and supervisory frameworks, and improve the regimes that govern corporate behavior. In the Fund it has led to a new emphasis on consideration of balance sheets in the whole economy; to the development of the Financial Sector Assessment Program—the FSAP; and to the Standards and Codes Initiative.

- We in the Fund have also learned the importance of country ownership. We give prominence to governments’ own priorities in program design. We support governments by reaching out to civil society. And we have streamlined the conditions attached to our lending so that they cover only issues critical to macroeconomic stability and growth.

3. For all the progress of recent years, Asian countries still face a number of challenges: financial



globalization, demographic changes, inequality, and continued poverty. Let me now talk about some of these challenges and the new opportunities that come with them.

4. Asia has already reaped many benefits from globalization, and it now plays a major role in the global economy. Asia accounts for about a quarter of GDP and global trade. And the trend is toward an even greater role, as Asian economies, most recently led by China and India, have become engines of growth for the world. Asia's increased weight in the global economy must now be matched with increased rights and responsibilities in the conduct of international economic policy. The international community can learn from Asia's successes. So it is important that Asia's voice be heard. Just a few months ago, our Governors, including some of you, took the first step in a process that will increase the representation of emerging market countries, including Asian countries, in the Fund. Decisions made in Asian capitals also increasingly have effects elsewhere in Asia and beyond. China's exchange rate policy has implications for the dollar/euro exchange rate which other Asian countries, as well as the Fed and the European Central Bank, must take into account. The increased significance of Asia in the world economy makes it all the more important to design national policies that promote Asia's development, rebalance growth in the region, and support multilateral solutions to global problems. And we at the IMF, through close engagement with Asia, seek to understand regional and global issues from the Asian perspective.

5. Financial integration among the major Asian economies represents a challenge but also a huge opportunity. Trade integration is already well advanced. Intraregional trade is up by a third since 1990, reflecting in part growing integration of production processes and regional supply chains. But integration of regional financial markets is only just beginning. Asia is not alone in facing this problem: the European Union has a similar mismatch in integration of trade in goods and services and financial integration. And the barriers to integration are also similar in Asia and Europe, especially difficulty in harmonizing laws, regulations, and market infrastructures. I was very pleased to be able to take part in two high-level seminars on financial integration in Asia, the second taking place in Singapore last May. We will continue to work with the region to promote financial integration. This has the potential to bring great economic benefits: better financial services for businesses; more efficient allocation of investment; and more incentive for Asia's citizens to invest their savings in Asia. These benefits will be all the greater if Asia's financial integration continues to complement integration with the global economy.

6. Asia, like other advanced and emerging economies, also faces demographic changes. Japan is already grappling with the fiscal implications of an aging population. Many other Asian countries will also face this challenge. The advice that the Fund has given to countries where the effects are imminent, including the countries of Western Europe, is to reduce structural fiscal deficits and public debt while they can, to provide for more flexibility and avoid the need for more drastic measures later.

7. Rising inequality within the region and within countries poses new problems. Again this is not a problem unique to Asia. Globalization has given rise to a rising premium on skills and education in all countries. The increases in inequality that this produces are compounded in emerging economies by the effects of a shift from agriculture to industry and services. I know that Asian countries are very conscious of the risks of rising inequality, and the importance of social harmony. The Fund and its members need to give priority to policies that will spread the benefits of growth while preserving the incentives that generate growth. Such policies could include measures to improve education and infrastructure, liberalize labor markets, and broaden access to finance, and strengthen efficient social safety nets.

8. It should be clear from what I have said so far that Asia's challenges are not unique. All around the world, countries are dealing with the opportunities and challenges created by



globalization. For our part, the Fund is reforming itself to help members address these challenges.

9. The governance reforms that I have already mentioned are an important part of this response. The next step, already underway, is to move forward with discussions on a new quota formula that will better capture the role of dynamic emerging markets in the global economy, and with plans for an increase in basic votes that will bolster the voice of low income countries in the Fund. I am deeply committed to the success of this reform. I think it is vital for the legitimacy of the Fund.

10. A second key step is to enhance the effectiveness of surveillance. We are taking a number of steps to improve the implementation of surveillance. We have already initiated Multilateral Consultations, bringing the resources of the Fund and members together to help form a shared analysis and collaborative approach to specific problems of common concern, starting with global economic imbalances. We are deepening our analysis of equilibrium exchange rates in a multi-country framework by extending it to major emerging economies. We are better integrating surveillance of financial sectors into country surveillance. Another element of the reform of surveillance is to modernize its legal basis. The aim here is that current best practice in the Fund's surveillance work be reflected in the Board's formal mandate to the staff. This would make the Fund's priorities more transparent and ensure that our surveillance is even-handed and focused. It should also raise the bar for all country surveillance to the level of current best practice. And here the largest shareholders should lead by example through openness to effective surveillance of their economies by the Fund.

11. Asia and the Fund have come on a long journey together, and we are now embarking on a new stage of that journey. With the perspective of a former finance minister as well as the head of the IMF, I am deeply respectful of what your countries and your institutions have achieved. The rapidity and scale of the resumption of growth in your countries has been extraordinary. The success of Asia's central banks in keeping or bringing inflation under control is impressive indeed. And the commitment of Asia to understand and overcome new challenges is clear, and is reflected in meetings such as this.

12. I am personally committed to working very closely with Asia on the next stage of our journey. I will be asking for your help and support in reforming the Fund. I can promise you our support as you tackle the challenges you face. I thank you again for your invitation, and I look forward to our discussion.

13. Thank you very much.