

Congratulatory Address
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Conference on
Global Financial Crisis, Future of the Dollar, and the Choice of Asia
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Mr. Duck-Koo Chung, Chairman of the NEAR Foundation and former Minister of Industry and Energy, distinguished guests, ladies and gentlemen. Good morning.

Let me express my gratitude to all of you for taking time off from your busy schedule to participate in the conference on the ***Global Financial Crisis, Future of the Dollar, and the Choice of Asia***, jointly organized by the NEAR Foundation and the Asian Development Bank Institute. Actually, this is the second conference organized jointly by the NEAR Foundation and ADBI. In August 2008, at ADBI in Tokyo, we held the first conference to discuss the then emerging sub-prime mortgage crisis, capital flows, and the Asian economy. The sub-prime crisis has now evolved into a full-blown global financial and economic crisis, the worst since the Great Depression in the 1930s.

This crisis is different from other financial crises we have observed over the last several decades not only in its breadth and magnitude, but in its origin. The crisis is global, affecting almost all countries in the world, not just a few, and its impact so devastating. The epicenter of this crisis is not a peripheral country but the United States, which is the largest and central economy in the world, and home to the most dominant global key currency—the dollar—and the world's most sophisticated and developed financial system.

So it is not surprising to see that the crisis has generated many important debates and posed several major challenges for the world economy and Asia. Let me point out five of these.

First, this crisis has raised the questions whether the United States will be able to remain the central economic power in the post-crisis period and whether emerging Asia—with China, India, and ASEAN at its core—will play a much bigger role in the world economy. It appears that Europe will not be able to replace the US as the most powerful economy—at least in the foreseeable future—as many European countries are also suffering, perhaps more severely than the US, from the ongoing global financial and economic crisis. The world seems headed toward a truly multi-polar world, where not only the US and Europe but also Asia will increasingly influence the developments of the world economy and finance and will increasingly share responsibility for global economic and financial management. In this sense, the recent shift of the global focus away from the G7/G8 to the G20 is a natural and healthy development.

Second, the crisis has cast doubt about the future role of the US dollar as the most dominant key currency. Despite the fact that the global financial crisis originated in the US, the value of the dollar is high because of the high global demand for dollar liquidity—due to the presence of counterparty risk, repatriation of the dollar back home following the “deleveraging” by US financial institutions, the increased need for dollar liquidity globally on the part of both financial institutions and non-financial firms conducting international businesses, and “safe-haven” demand for dollars. However, the large size of public spending in the US for fiscal stimulus, financial sector support, and bail out of automobile and other firms will eventually bear on the country’s ability to service debt, and this may put the future of the dollar in uncertain territory.

The recent suggestion made by Governor Zhou Xiaochuan of the People’s Bank of China that the US dollar should be replaced by the SDR as the global reserve

currency may make good sense at least in theory, although in reality the reserve currency role of the dollar will not go away anytime soon. The reason is that the key currency role of the dollar has been supported by its network externality, incumbency “inertia” and, more fundamentally, the deep, wide, and liquid financial markets for dollar-denominated instruments. In contrast, the SDR has been used only by the IMF and its member authorities largely for accounting purposes and not in the private markets. Nonetheless the role of the dollar may decline as a trend, so it is useful to consider the future shape of the international monetary system. Will the euro regain its strength and credibility? Will the Chinese yuan rise to become the third international key currency, following the dollar and the euro and surpassing the role of the Japanese yen? Even though the yen is a fully convertible currency, it has not become an international key currency. Even though China has recently embarked on initiatives to internationalize the yuan for trade settlement through the banking system, it would take a long time for the yuan to become a fully convertible currency—that is, a currency to be used and traded freely and globally for both current account and capital account purposes. This suggests that, as Asia is rising to become the world’s largest economic bloc within several years, the region needs to seriously explore the possibility of developing its own currency or currency basket.

Third, the crisis has raised the question whether the US consumption decline is a permanent or a temporary phenomenon. The ongoing crisis is forcing adjustment of current account imbalances in both the US and Asia through the reduction in US consumption. If this is a permanent or semi-permanent process, it has significant implications for Asia’s growth paradigm. Asian countries can no longer rely on US consumers as their growth engines and must find their own sources of growth by changing their development paradigm from an excessively export-dependent one to a domestic and regional demand-led model. Essentially Asia must increase consumption and investment on a permanent basis, and transform the supply side of the economy from tradable toward nontradable activity. Sustained expansion of consumption requires structural reforms to strengthen

social sector protection—health, education, pension systems, and unemployment insurance—reduce urban-rural income disparity, and improve efficiency of financial intermediation for consumers. Infrastructure investment as well as improvement in the investment climate is needed to stimulate investment in countries where investment has been inadequate or stagnant. Productivity of the services sector needs to be upgraded as this sector is the major component of nontradable activity and has been relatively weak in Asia—except in India. Regional market integration is essential as it stimulates more regional trade in goods and services, creates new business opportunities, and facilitates mobilization of regional savings for regional investment.

Fourth, the crisis has raised the question whether emerging Asia should rely on the IMF or a regional reserve-pooling arrangement for crisis prevention and resolution. The G20 meeting in London agreed to increase the financial resources of the IMF from US\$250 billion to US\$750 billion, and the IMF introduced a new financial instrument, called the Flexible Credit Line (FCL). Looking at its recent interventions in Europe, the IMF appears to have become more flexible, focused, and effective than during the Asian financial crisis in 1997-1998. But many emerging Asian economies have doubts about the value of the IMF for them. Many Asians seem skeptical if a significant IMF governance reform will take place as Europeans are unlikely to give up substantial voting powers for Asians, and Americans may not give up the only veto power. They expect only marginal changes.

A few advanced countries in the region like Korea and Singapore have been able to secure international liquidity from the US Federal Reserve (without going to the IMF and without any conditionality), but other middle-income countries have not had that privilege, and hence are more vulnerable to capital flow reversals. The recent agreement to multilateralize the Chiang Mai Initiative (CMIM) and create a surveillance unit is a significant step forward as this implies that ASEAN+3 countries are now heading towards the creation of a *de facto* Asian

Monetary Fund. However, most emerging Asian economies may not wish to use CMIM as its use—beyond 20%—is constrained by its link with IMF programs. To make the middle-income countries more secure financially, significant progress is needed for CMIM to further reduce IMF links, eventually to zero, by raising the effectiveness of its regional surveillance. For the time being, however, in this emergency period, middle-income countries need to be protected by making CMIM operations more flexible in a way comparable to the IMF's FCL.

Finally, the US dollar may not be strong forever. Asia needs to be prepared for eventual dollar depreciation, beginning with a serious discussion about regional exchange rate policy coordination. Asian countries need to discuss how Asian cross rates can remain relatively stable in the event of a sharp, rapid depreciation of the US dollar vis-à-vis the Asian currencies. From the perspectives of both preserving macroeconomic and financial sector stability and securing international price competitiveness, joint, coordinated currency appreciation is highly desirable. Collective currency appreciation in Asia can also facilitate the region's growth paradigm shift away from excessive export dependence on the US market towards regional demand- and nontradables sector-led growth. The introduction of an Asian Currency Unit, consisting of the ASEAN+3 currencies and the Hong Kong dollar, will be useful in strengthening the region's policy dialogue for greater exchange rate policy coordination.

I believe that all of these important issues will be discussed and debated here in the conference. Hopefully, these discussions and debates can identify key policy measures to be taken by Asian governments to achieve stable, sustainable economic growth for all.