

Closing Remarks

Asia's Role in the Post-Crisis Global Economy

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The theme of this conference is Asia's role in the post-crisis global economy. Let me start by commending our organizers for their prescience. When their organizational efforts got under way many months ago, little did we know that discussions would have now turned to whether China and other Asian countries might provide resources, either via the International Monetary Fund (IMF) or directly, to help Europe to stabilize its finances, or that the most recent G-20 summit in Cannes would have revolved around this question. Asia's role, as everyone present here today knows, is now very much at the forefront of discussions of the global financial crisis. In a sense, the organizers' prescience is reassuring. It reassures me that there will, in fact, someday be a "post-crisis global economy"—that the current crisis, which has been dragging on now for more than three years, will eventually come to an end.

The papers they have commissioned similarly speak to the theme of Asia's role. They establish how deeply Asia is integrated into the global economy. The paper by Ted Truman documents the extent of capital flows between emerging Asia and the rest of the world, carefully distinguishing private from official flows. Pierre-Olivier Gourinchas covers similar ground but focuses more closely on Asia's dependence on the supply of liquidity—short-term capital—from the United States and, especially, Europe. This is something of which we have been strikingly reminded by current events, as European banks desperately deleverage and, in the process, shed their Asian loans. The paper by Eswar Prasad and Lei Ye describes the growing role of the Chinese renminbi, Asia's leading currency, in the international monetary system. The paper by Rick Mishkin and coauthors, taking Korea as a case study, focuses specifically on bank-intermediated flows, showing that these are strongly affected not just by domestic monetary policy but also by policy in the rest of the world, not least in the United States. We heard more about this from Deputy Governor Jun Il Kim. And what is true of Korea is also true, to a greater or lesser extent, of other Asian countries. The paper by Eswar Prasad, meanwhile, provides evidence of China's growing role in the global monetary and financial system.

While these papers all focus on monetary and financial linkages as a way of establishing Asia's deep integration into the global economy—appropriately for a Federal Reserve Bank-sponsored conference—I would observe that the same is true of trade linkages. Intraregional trade may be the most rapidly growing component of Asia's trade, but the largest share of the exports of Asian countries still go to other parts of the world. We saw in 2009, when the volume of trade collapsed, just how sensitive Asian economies are to disruptions to those self-same trade flows. This is a reminder that Asian countries can contribute to building a more robust post-crisis global economy not just by deepening, diversifying, and stabilizing financial markets and flows but also by deepening, diversifying, and stabilizing trade flows. Here the Trans-Pacific Partnership (TPP) highlighted by President Obama on his recent trip to Asia—and Japan's decision to participate in the TPP negotiations—points a way forward in the absence of progress on the Doha Round. Were China to join the TPP negotiations, the initiative would be more significant still.

The way forward in the realm of money, finance, and macroeconomic stability is less obvious. Should countries concentrate their efforts at the national, regional, or global level? The papers suggest, not unreasonably, that the answer is all three. Responsibility for inflation control, Lars Svensson's paper reminds us, rests ultimately with national monetary authorities. Restraining the strongly procyclical behavior of banking and financial systems is first and foremost a task for national regulators, the Mishkin et al. paper implies. The papers provide much sage advice about how the monetary policy toolkit might be expanded given today's challenging economic environment, and about how macroprudential policies should be implemented in practice.

I would, however, flag the absence of a companion paper on fiscal policy. What is best practice in this area? European countries are moving en masse toward debt brakes (known elsewhere as balanced budget rules). Should Asian countries follow, or should they be wary about locking themselves into a fiscal straitjacket? Might they better look to the experience of a country like Chile, where independent commissions provide forecasts for both growth and commodity prices and law requires the budget to be balanced over the business and commodity cycles, leaving the executive little leeway to adjust spending beyond what is consistent with those forecasts and their implications for revenue?

The papers we have heard are also unanimous about the continuing applicability of Tinbergen's assignment rule and Mundell's principle of effective market classification. Monetary policy should be assigned to the pursuit of price stability, regulatory policy to financial stability, and other policy instruments (there's that pesky fiscal policy again) to the pursuit of other objectives. Lars

Svensson's paper makes this point in a forceful way. To be clear, the Tinbergen assignment rule does not mean that monetary authorities should proceed in blissful ignorance of the impact of their decisions on financial stability, or that financial stability authorities should ignore the implications of their decisions on prices and economic activity. It does mean, however, in conjunction with the principle of effective market classification, that they should focus primarily on the target on which their instrument has its primary impact.

More interesting is what to do when the number of instruments is smaller than the number of targets and when some instruments are temporarily out of commission. This was the case with regulatory policy, I would argue, before the crisis, and is the case of fiscal policy, in some sense, now in the advanced economies. Lars suggests that, under these circumstances, monetary policymakers need to step up: Monetary policy then should become the "last line of defense of financial stability." But what exactly "last line of defense" means for the conduct of monetary policy, when the central bank does not control financial stability instruments, and those who control them are asleep at the wheel, could be spelled out in more detail. What the monetary authority should do *in response* to a crisis may be straightforward: It should engage in last-resort lending, quantitative easing, credit easing, and the like. More interesting and controversial is what it should do to head off a crisis—other than hope that the authorities responsible for deploying financial stability instruments are up to the task.

While the task of securing macroeconomic and financial stability starts at home, the growth of macroeconomic linkages and monetary and fiscal spillovers highlights the need for policy coordination at the global level. National regulators may resist applying tight macroprudential policies that threaten to drive financial services offshore; if so, this is something that needs to be addressed by coordinating the application of those measures. It is a good thing, in other words, that we have the Basel accords and a shame that there was an inability in the most recent round of Basel negotiations to agree on both a uniform international standard for countercyclical capital and additional measures to rein in systemically important financial institutions. Monetary and fiscal authorities, for their part, may resist acknowledging that their policies have important cross-border spillovers. It is a good thing, in other words, that we have the International Monetary Fund, and it is important to continue strengthening its role by increasing its resources, rebalancing quotas and executive board representation so as to strengthen Asian countries' voice, and perhaps using it as a vehicle for regularizing the provision of emergency swap lines. It is a shame, on the other hand, that Asian countries have not been able to get over their IMF phobia.

Yet progress here is—how to put it politely—less than might have been hoped. As the Truman paper observes, effective policy coordination has multiple prerequisites. It requires identifying the existence of a health-threatening condition; a shared diagnosis of its nature; agreement on the appropriate treatment; a capacity to adjust the dosage if the patient doesn't respond as anticipated; and changes in lifestyle to prevent that problem from recurring and becoming a chronic condition. (You will notice that I have replaced the language of policy coordination with the language of health care, which is an occupational hazard for someone who is married to a medical professional.) There is, I think, agreement between Asian countries and countries elsewhere, and specifically between the United States and China, that the global economy has a health problem. Indeed, it has a complex of problems: The patient is low on energy, is prone to spells of dizziness, and is subject to panic attacks. (I will now stop with the medical analogies.) But, three-plus years of G-20 working groups, summits and IMF surveillance exercises notwithstanding, there is still a lack of consensus on the causes and therefore on the appropriate treatment. There really is no alternative to continuing with efforts to build that consensus, but the results continue to disappoint. We need to do better.

So if global cooperation is imperfect, given the unavoidable difficulties of reaching a consensus on the nature of the policy problem and coordinating the associated policy adjustments when such a large and heterogeneous collection of countries is involved, but at the same time retreating into autarky—ignoring interdependencies—is not an option, then isn't there a case for policy coordination at the regional level? This was Asia's reaction to its 1997–98 crisis. Policymakers in the region can point to the Chiang Mai Initiative Multilateralization (CMIM), the ASEAN+3 Macroeconomic and Research Office (AMRO), the Asian Bond Fund, and the Asian Bond Markets Initiative as among their achievements. But it is tempting to conclude that there is less here than meets the eye. The CMIM has never been utilized. AMRO's remit is research rather than surveillance. (It's not the "ASEAN+3 Macroeconomic Surveillance Office.") Asian financial systems are still heavily bank based, and the development of bond markets remains painfully slow.

Why hasn't regional macroeconomic and financial cooperation been more extensive and successful? The Truman paper explains this on the grounds that Asian countries are exceedingly diverse in size and stages of development, and that because some of them are key players on the global stage they may therefore prefer multilateral to regional approaches to cooperation. To this I would add that Asia is home to an extremely diverse set of political systems. There is political diversity in Europe as well, but democracy, rule of law, and human

rights are prerequisites for admission to the European Union. And then there is the so-called “ASEAN way”—the norm of noninterference in neighboring countries’ affairs, which by definition limits the scope for firm surveillance at the regional level. Finally, Europe’s crisis is a reminder that, even where these obstacles do not exist, or where they are at least less formidable than in Asia, effective policy cooperation at the regional level is very hard work indeed. The implication of Europe’s crisis is not that Asia should turn away from regional cooperation but, rather, that it should be careful not to put all its eggs in that basket.