Asia in the Global Economy[*]

Dominique Strauss-Kahn

I am very happy to have the opportunity to address an audience in Seoul after the meetings the IMF just held in Daejeon. Entitled *Asia 21*, these meetings included representatives of many of the governments in Asia, think tanks, and NGOs. In my view, these meetings were very successful in beginning to rebuild the relationship between the IMF and Asia—which I think is fair to say is not in good shape due to bad memories from the Asian financial crisis 12 years ago. At that time, I think the IMF did the job that it was mandated to do, but did it in a way that left behind bad memories and bad feelings. It is certainly time to take stock and begin to rebuild the relationship at a moment when the economies of Asia are buoyant, and it is impossible to consider the future of the global economy without considering Asia. I would like to share four or five point that I came away with from *Asia 21*.

The first point deals with the way in which Asian countries are recovering—and are in fact leading the global recovery—in comparison to other countries. In the view of the IMF, the recovery is rather strong and comes sooner than expected. The most recent update to the World Economic Outlook was released last week in Hong Kong with some revision upwards of the forecast. Predicted growth now stands at 4.5% for the global economy this year, which is rather strong. Of course, the main problem is that this is a multi-speed recovery. The situation is relatively good in Asia and in most countries of South America—including Brazil but also smaller countries like Chile and Peru. Africa is also doing relatively well, especially compared to how Africa fared in previous economic crises. The traditional lag between global recovery and recovery in Africa—which used to be about one year—has vanished. The reality is that African countries, at low levels of income of course, have recovered with rates of growth around 5% or 6%, which is good news for the continent.

As for the United States, the picture is uncertain. The IMF's forecast is for growth of slightly more than 3%, but it is difficult to know how accurate this is. The IMF is more optimistic than the consensus, and believes that the recovery in the United States is strong and that unemployment will eventually decrease at the end of this year. However, there is some uncertainty. The main problem in global growth remains primarily in European countries, where the forecast of the IMF is between 1% and 1.5%—for both the coming year and the year after that—which is obviously too low to bring down unemployment. This means that the European countries will remain in a problematic state for a period of time.

This multi-speed recovery is the reason why the exit strategy cannot be the same for every country. The way the crisis was tackled at its onset was nearly uniform. Following the advice of the IMF, stimulus packages were enacted to avoid a crisis that could have been as severe as the Great Depression. Actions taken around the globe were almost identical on the fiscal side. But obviously the exit is a different game. The exit cannot be the same in Asia, where average growth is 7% this year, as it is in Europe, where average growth will be between 1% and 1.5%. So exit strategy has to be tailored to the country, and that is one of the reasons the G20

[*] Transcript of a speech given at the IGE/Prudential Business International Finance Lecture on Tuesday, July 13, 2010

in Toronto was a bit messy. Following those meetings many negative comments were made, saying that the countries did not agree, with some nations pushing for continued support while others were pushing for an exit strategy and fiscal austerity. Well, it is natural that these nations have different opinions because they are facing different situations. Economic coordination does not mean that each nation has to do the same thing. It means that policy that will be implemented will be discussed with other nations and will fit the situation a country is facing.

The current recovery is fragile, and it is fragile because downside risks are still present. There is an ongoing discussion on the possibility of a double-dip recession, but the IMF does not believe there will be such a double-dip. The baseline scenario is a scenario in which the recovery continues. Of course, there is still some risk, and in the short-term no one can say that another crisis is absolutely impossible. The IMF does not believe it will happen, but it has to be considered—and those risks need to be attended to. There are two primary risks.

One of those risks is the fiscal situation of some countries. Of course, the example that immediately comes to mind is the case of Greece, which is well-addressed today by the European Union with the support of the IMF. Yet, even if it is well-addressed, and even if I do not believe that any other European country could find itself in the same situation, one never knows how markets may react. The second risk has to do with emerging countries. A lot of liquidity still exists in the global economy, and at the same time the appetite for risk is returning. Of course, most investors are reluctant to invest in advanced economies, and so they focus on fast-growing emerging economies. This creates huge capital inflows for those nations. This is welcomed when those inflows go towards foreign direct investment (FDI), but it is more problematic when those investments are temporary. So the question for those countries is how to manage those capital inflows as they are likely to create asset bubbles and disrupt economic policy. The IMF does not believe that any kind of crisis could materialize through this risk, but it should not be discounted.

One of the lessons of this crisis is that there is no domestic solution in a globalized economy. Therefore, there need to be globalized solutions. Slow growth in Europe—which represents about 25% of the global economy—cannot be without consequences for Asia. This is especially true for exporting Asia, whose market is mostly in the United States and Europe. So no country can sit back and say that this is not its problem—that it is only concerned about its own economy and that of its neighbors. Nations must have in mind that the globalized economy makes it necessary that they depend on one another.

What is very remarkable is the resilience of the Asian economy during the crisis. While the financial sector was not hit directly by the subprime problem—most Asian banks did not hold any kind of subprime assets—the economy has been hit by the downturn in the global economy. Part of the reason that the financial sector resisted the crisis so well is because of the cleansing of this sector done during the Asian crisis—even though it was done at a very high cost. It probably could have been done at a lower cost, but the result remains the same. This is true in Korea and in many other Asian countries. These banks navigated the current financial crisis without too many problems and were able to continue financing their recovery.

So, this concludes the first point. The global economy is not totally out of the woods, but the apex of the crisis has passed. There are still problems going forward, depending on which

part of the world is examined, but it is clear that the Asian economies have been very resilient. It is obvious today that Asia is leading the recovery, the balance of power has changed, and the share in the global economy of Asian countries will increase in the coming decade.
My second point is that—in looking to the future—the continuing recovery of Asian nations needs to be closely watched. As I mentioned, many believe that this recovery cannot solely rely on exports. The idea is not to say that these nations should export less, but that they may export less in the future because of weaker demand in advanced economies. In this case, a second engine of growth will be needed. Obviously, the idea is that in some countries—primarily the large countries—there will be a shift from a model in which growth was mostly export-led to a model in which growth is fueled by domestic consumption. Of course, this does not mean anything for small economies. Singapore cannot focus on its domestic market, but it is important for nations like China. The idea is certainly not to say that nations like China should back off from globalization to focus on the domestic economy and not be open to the rest of the world. Instead, these nations need to be aware that exports may not be as big as they previously were due to persistent weak growth in some parts of the world. In this case, these nations need to be able to ignite a new engine of growth, and this has to do with developing trade in Asia—especially trade in products that have final consumers in Asia. Much of the trade in Asia is currently in products whose final consumers are outside of Asia. How to establish this new engine depends on the country. In some countries, consumption is obviously the main target, which is the case for China. In most other Asian countries the question is about private investment and building on public investment and infrastructure. All of this means that strategies have to be tailored to the country. However, there are two caveats.

These two caveats have to do with inequalities—inequalities among countries and inequalities within countries. In Asia there are many low income nations, and the question is how to organize a transition from low income levels to emerging country status. That is not a given, and it will not happen by chance. Long ago Korea was a poor country, but it showed that it is possible to make that transition. However, it will not happen alone, and having all of the countries catching up is one of the problems Asia will have to address.

Inequality within nations remains a problem, even if much progress has been made. There is still a large proportion of poor living in Asia, so creating inclusive growth is an issue that needs to be addressed. When the 4 Asian dragons (Korea, Taiwan, Singapore, and Hong Kong) had high levels of growth it was inclusive growth. However, in the last 10 to 15 years the model has changed. In China, development has not done well in reducing inequalities. If Asia wants to have a smooth path of growth at high levels in the coming decade, these two inequalities need to be addressed, which leads to the third point.

With current rates of post-crisis growth—and what has been achieved before the crisis—the role of Asia in the global economy has changed. The question of how the voice of Asia can be heard is certainly an interesting one. The G20—which is one of the most important events to take place during the crisis—includes 6 Asian nations, which shows that Asia is well represented. Of course, Korea is chairing the G20 this year, but the G20 is not everything. While it is an important body, and a formal one, it is yet to be seen how it will play out. In the G20 it may be a little easier for Asian to voice its opinion because of Korea's leadership. This is the first time that the G20—at the level of head of state—will be chaired by an emerging country. It is a huge responsibility, and thus far Korea has handled it very well. I think the agenda which has been created by the Korean authorities is exactly what is needed.

The role of Asia is important and one of the core activities of the G20—now that the worst of the crisis has passed—is to determine how coordinated growth can take place. Coordination was one of the main features during the crisis, and now the question is if it will continue after the crisis. To do this the G20 has decided to set up what is called the Mutual Assessment Program (MAP), a framework that the IMF was asked to build. For this, the domestic forecasts which have been proposed by different countries are compiled to find if these domestic forecasts then add up to create a consistent global picture. If the picture is not consistent, the IMF is then tasked with making it more consistent by identifying the primary reasons for the initial inconsistencies. In Toronto, the IMF showed that coordinated action by the G20 members would increase growth by 2.5% over 5 years, which would represent more than 30 million jobs and bring 40 million people out of poverty. That is a goal that the leaders clearly endorsed in Toronto. To try to reach this common goal, the IMF needs to outline clear policies which need to be implemented country by country. It is well-understood that all nations can benefit—that it is a win-win game—if economic policies are coordinated among the G20 members. Again, the role of Asia in this is major. Representing nearly 30% of the global economy, it is impossible to achieve the goal I was mentioning without having the active participation of Asian countries.

My fourth point has to do with renewing the relationship between Asia and the IMF. In an institution like the IMF—the role of which has certainly been enhanced during this crisis—what is the role of Asia? I think it is understood that it is in the interest of Asia to have its say in the global economy, and to renew its relationship with the IMF. It is also in the interests of the IMF, which cannot be a multilateral institution dealing with the global economy without dealing directly with Asia. What does it mean? It means that the IMF needs to engage more—and in different ways—with Asian countries. But it also means that some old devils have to be laid to rest. For instance, I remember the IMF meeting in Hong Kong in 1998 when I was finance minister. There was an elephant in the room that no one wanted to address, and it was the idea—launched by the Japanese—of an Asian Monetary Fund (AMF). I was a young minister at this time, and did not understand exactly what was at stake. People were talking—including the IMF—about this possibility, saying that it was something that needed to be fought against, that there could be only one IMF. As always, when an international institution is built, it takes time. It is now 12 years later, and the Chiang Mai Initiative (CMI) has just arrived, which is possibly the beginning of the AMF.

Contrary to the idea that the IMF should actively oppose this, I think exactly the opposite. Regional arrangements are welcome, and there is no reason why the IMF could not work with regional entities when they exist. The IMF's cooperation with the European Union on the Greek case—which the IMF was happy not to face alone—proves the point. Initially, the Europeans were not happy to deal with the IMF, but finally the conclusion was reached that even if Europe has an organized, deeply integrated economy, it was not able to deal with the Greek case alone. The European Union needed access to the funds of the IMF, as well as experience and expertise that does not exist anywhere else, and finally came to the conclusion that the best way was to organize cooperation between the European Financial Stability Facility (EFSF) and the IMF. In the same way, I see the cooperation between CMI and the IMF to be rather easy, and it is the right thing to do. In other parts of the world—like Latin America—if another kind of initiative goes in the same direction, I would be very happy to cooperate with them. So this is the kind of old problem that I think must disappear and is disappearing. There are enough current problems that extra problems do not need to be put on the agenda.

One of the current problems is the so-called problem of quota invoice for Asian countries, which has to do with the representation of Asian countries in the IMF. As the Pittsburgh Communiqu é requested, the IMF has committed to shifting 5% of the voting rights from advanced economies to dynamic, emerging economies—from over-represented countries to under-represented countries—by January 2011. I think it will be possible, at the request of the Korean Chairmanship of the G20, to complete it for the Seoul meeting in November. This will be a huge achievement. Cleary, this is not easy— shifting 5% means that some countries must see their voting power reduced. On my desk I have a long list of countries wanting to increase their share, but I have a very short list of countries wanting to decrease their share. The total has to add up to 100%. My only luck in this story is that I am not really in charge of this because it is a question to be handled among the membership. In fact, staff and management of the IMF are working with the membership to try to achieve this, but it is a rather difficult ball game. Nevertheless, I do believe it is possible.

More important than the quotas is to make the board of directors of the IMF more representative. There are 24 members on the board, but the make-up needs to be reshuffled so that some of the anomalies will be eliminated. Currently, some larger economies are less represented than some smaller economies, which looks very odd. After the reorganization, 12 of the 24 board members will represent the 12 largest economies. It means that the share of Asian countries will increase which is an important step to make Asian nations feel more at home in the IMF.

I believe that the IMF has to become the second home for Asia. In order to feel at home, one needs to have enough room. To have enough room means that some countries, especially European countries, have to relinquish some portion of their voting rights to Asian nations, as well as to Brazil and a few others. It is a difficult deal but I think it can be accomplished. All of this is part of what I call the Daejeon deliverables—three points that resulted from *Asia 21* and need to be accomplished.

First, the analysis of the IMF has to be more useful and more available for Asian countries. This analysis has to do with early warnings—new kinds of early warnings that the IMF is currently constructing—as well as spillover analysis which looks at how events in one country may have consequences for other nations. The IMF also has to focus on producing more even-handed analysis because it has been said by most emerging countries—and I do not care if it is right or wrong but it cannot continue—that the IMF is not as tough with advanced economies as it is with emerging economies. When one sees Greek unions demonstrating in the street, I am not quite sure people can continue to say the same thing. If there is some perception in Asia that the IMF is not even-handed enough then progress must be made on this. Of course, this has to do with increasing outreach, to repeatedly explain that the IMF is at the service of the member nations via technical assistance, crisis programs, and it always aims to help nations fix problems.

Second—and perhaps most importantly—is building the financial safety net that has been proposed by the Korean authorities. It relies on the idea that the IMF needs to renew its facility tool kit to be more closely related to problems that may occur in the current global economy. We built the Flexible Credit Line (FCL) program during the crisis, which has been very helpful but can be improved. Beyond the FCL, we may need a precautionary credit line for other countries—a set of 40 or 50 countries having rather good policy in place—that could possibly be hit by some form of systemic crisis. On a third level, an idea that has been discussed at length with the Korean authorities is that of a multicultural approach to working with the IMF. This is an important idea that would attempt to counteract the stigma which is still attached to a country dealing with the IMF. When a country comes to the IMF it means that the country has a problem. Having many countries—in the same region for instance—when facing the beginnings of a systemic crisis, approach the IMF and jointly request that the IMF put in place some form of safety net could effectively fight this stigma. This is being worked on, but is not yet completed. In fact, it is far from being completed as it is a difficult discussion within the board of the IMF, but I am confident that it will be done for the G20 meeting in Seoul. Finally, the last deliverable, which I spoke about already and will not elaborate further, has to do with the quota invoice.

These three deliverables are the agenda which have been established in Daejeon, and to which the IMF is committed for the coming year. If all of these points are accomplished—and they must be accomplished for the Seoul summit—then one year from now it will be possible to say that the relationship between Asian and the IMF has not only changed, but that it has returned to normalcy. Asia—representing nearly one-third of the global economy—will have its voice and its correct representation in this global institution. But the leadership of Asia has to go beyond Korea's chairmanship of the G20. For most Asian countries the G20 is a very important event, but life will go on after 2010. Thus, preparations need to be made for what will happen in the global economy in the coming 3 or 4 years. In the long term, as Keynes said, we are all dead. So, let's focus on the coming three or four years. That will be enough.

Q&A

Q Two questions: First, what is the IMF's strategic position towards the European Union, especially towards the financial crises of the so-called PIGS countries—Portugal, Ireland, Greece, and Spain. Is the IMF going to deal with the EU as a block or country by country? Second, do you think Korea's past experience with the IMF will help to solve the PIGS problem? Do you think the same strict conditionalities will be imposed or will the conditionalities vary by country?

A First I would strongly advise you to use the acronym GIPS rather than PIGS. This has become the internationally accepted way of referring to these nations. Moving on, the IMF membership is made up of individual countries and the European Union is not a member of the IMF. While I have nothing against bankers, the IMF is not a commercial bank. So it only assists a country when a request is made. This was the case for Greece, and the same would be true for any other country that may need support.

On the second point, experience from the past is certainly useful. The fact that conditions are necessary when support is given by the IMF is challenged by no one. When the IMF needs to work with a country, in most cases it is because there are things that need to be changed. The conditions are there to ensure that the changes agreed to by the IMF and the government will be implemented. But the experience of the past—particularly during the Asian crisis—is that the IMF tried to fix too many problems at the same time. If you take your car to the mechanic because of a problem with the wheel, you want the mechanic to fix the wheel. You do not want the mechanic to also tell you that there is a problem with the engine, the steering column, and the windows. You are unable to pay for everything. So countries cannot deal with fixing all of the problems at the same time. With the best intentions, the IMF was trying to work with the countries to fix all of the problems, which is impossible. It makes it politically impossible, economically very difficult, and very painful socially. So the IMF has learned to be more focused on what is absolutely required to fix the problem at hand, and that largely comes from the lessons drawn from the Asian experience. However, the IMF is still the IMF, and that means that there is no way it could deal with a country without conditionalities because what needs to be done has to be done. I think the Greek program is well-adjusted. It is not too tough because it has to be implemented. It will be painful for the Greeks, but it cannot be too painful because then it will not be implemented. On the other hand, it has to be tough enough to address the problem. These kinds of measures and judgments draw heavily on the lessons from the Asian crisis.

Q Is there a chance that emerging economies will set up their own regional safety nets, and if they do, will the IMF support these safety nets?

A As in any institution there is a more conservative element that is reluctant to go forward, and sometimes that is useful because it avoids mistakes made in going too fast. The discussion which is now taking place among the board of the IMF regarding these safety nets is on improving the processes which were put in place. I am confident this will be delivered. The question is that if it does not happen, is there any solution at the regional level? Well, I said before how much in favor of regional arrangements I am, and I do believe that regional arrangements are very important. However, I do not believe those regional arrangements can work alone. The example of the European Union is an excellent one. There is nothing similar to the European Union in Asia. It took 40 years to build something as integrated as the EU, and even this arrangement was unable to deal with the Greek case alone. So I think there is no chance that regional arrangements will be enough due to the linkages of the global economy. On the other hand, I am not saying that the IMF alone will be enough. That is why the best solution is coordination. Having complementary institutions is the right way to go.

Q Rather than being located in one place, and waiting for a country to come knocking on the door, would it not be much better for the IMF—and the world—to have several locations around the globe? This would do much more to integrate the IMF into the world economy, allow the IMF to see problems before they happen, and allow for greater coordination.

A In a crisis period, the IMF cannot intervene in a country before being asked. Of course, on a day to day basis the IMF tries to be proactive. It carries out its core business—giving policy advice and technical assistance when needed—which flies under the radar because the IMF is only seen in the headlines during times of crisis. Half of the IMF's resources are devoted to building early warning systems, attempting to create a view of what might happen in the event of a crisis, looking at spillovers, etc. So this idea that the IMF is just a bookkeeper waiting for nations to ask for support is not correct.

Having headquarters in Washington D.C. is clearly not ideal, and it would be much better if the IMF could have regional headquarters. However, in the treaty that established the IMF it clearly states that the headquarters of the IMF must reside in the territory of the largest shareholder. That is why when I was Finance Minister of France I fought strongly for a single chair for the European Union. The EU would have then been the main shareholder, and the headquarters could have been in Paris. But the real question is whether or not the IMF has enough people in direct contact with its members. Certainly, it would be very good for the IMF to have more people in the field. But it is a cost question and a strategy question. With regards to cost, there is a budget and there are budget constraints. It could be said that being too tough on the budget is ridiculous if a crisis can be avoided, and if the gain from avoiding that crisis is much greater than the cost of preventing it.

With regards to strategy, it is also difficult. It is very important for the IMF to be even-handed but also consistent. To be consistent the IMF needs people working together in the headquarters. That is one major difference with the World Bank. The World Bank is much larger than the IMF because the World Bank deals with projects in many different countries, and that requires that people be in the field. However, the IMF could not decentralize—with people meeting together from time to time—because then people may not have the same view of the global economy. So the IMF needs to be centralized. Nevertheless, it could still have more people in the field. In most countries the government and the IMF representative work very well together, and the authorities are happy to be able to exchange ideas and discuss policy with the IMF representative. So we do need to try to be more present in the field.

Q What is your view on capital controls and the Tobin Tax?

A My view is very pragmatic on this. I previously spoke about large capital inflows, and how those inflows can be very disruptive for a country's economic policy. So what can the country do? The normal answer is to let the currency appreciate, but there is a limit. At some point in time the country may believe the currency to be at an appropriate level, that further appreciation will damage exports, and that this is not advantageous. The country then moves to the second line of defense which is to accumulate reserves and then sterilize those reserves—leaving them unsterilized can create problems with monetary policy. Yet, this cannot be done forever. The question then becomes one of monetary policy. There may also be a third line of defense dealing with prudential rules and the way in which capital markets and stock markets function. However, this also has its own limits. Then, when all the tools have been used, there may still be large capital inflows.

I think countries have to be pragmatic. Capital controls can be useful, but of course there are also drawbacks. It should only be done on a temporary basis, and it should not be expected to solve the long-term problems. It cannot be a way to hide and avoid making needed structural reforms. But in the short-term, when experiencing capital inflows that are disruptive and may derail economic policy, capital controls are a pragmatic answer that countries cannot reject for only ideological reasons. Eight months ago Brazil decided to put capital controls in place, and they called the IMF. I told Brazil that it was not that I did not like it, but that I did not think it would effective. Brazil enacted the control, a kind of Tobin Tax, and it was somewhat effective, but only for a very short period of time. That is a demonstration of the pragmatic view I was mentioning. If a policy is effective but has some drawbacks, but those drawbacks are less costly than doing nothing, then the policy should be implemented. If the drawbacks are more costly than the advantages then the policy should not be implemented. It really has to be seen pragmatically. In any case, that kind of policy can only be temporary. When there are prolonged capital inflows structural measures need to be taken.