STRENGTHENING THE INTERNATIONAL FINANCIAL ARCHITECTURE

The following speech was made by Jin Nyum, the Minister of Finance and Economy on January 14, 2001 at the ASEM Finance Ministers' Meeting held in Kobe, Japan.

Today, I would like to share with you my assessment of the progress made so far on reforming the international financial architecture. In doing so, I would also like to share a few of my own reflections on this important issue.

An assessment of recent discussions on r eforming the international financial architectur e

It has now been more than three years since the financial crisis hit many countries in Asia. Since then, Asia has considerably recovered from the crisis, thanks to each countrys own effort as well as the assistance provided by the international community, including ASEM.

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Most of you may agree that to sustain the recovery of crisis-hit countries and avoid recurrence of a crisis, we need to improve the international financial system. Such reform is also crucial for promoting stability in the world economy and global markets.

Needless to say, efforts by the international community and individual countries have led to significant progress on this front. Many countries are in the process of enhancing transparency in their respective economic system, and there is a growing consensus for the need to properly monitor and regulate short-term speculative capital flows. Most of all, the establishment of G-20 was a milestone in these efforts, as it created a channel for conveying the perspectives of emerging market economies.

While we welcome these clear signs of progress, most of the reforming efforts so far have not rendered tangible results. Many areas still have ample room for further progress.

The first concern is that the international community has lost its enthusiasm for reforming the international financial system as conditions improve in crisis-affected economies. But despite such recent improvements, lets not forget that it takes more than strong macroeconomic performance to ensure a sound and stable global financial system. In this sense, the international community must not lose its resolve for carrying out this important task.

The first concern is that the international community has lost its enthusiasm for reforming the international financial system as conditions improve in crisis-affected economies.

Secondly, and perhaps more importantly, I would like to draw your attention to the fact that main dialogues for reform have been led by the G-7 countries. And, as such, views of emerging countries have been often overlooked.

We must remember that the recent crises are not entirely due to the vulnerability that existed within the crisis-hit countries own financial systems.

The shortcomings of the international financial system itself need be held accountable as well. That is, its incapacity to adapt to new developments in the world economy, especially the surge and the reversal of private capital flows.

In order to avoid such a calamity, our goal must consist of more than just strengthening domestic financial sector and implementing sound macroeconomic policies. To fully rectify the structural impediments in the international financial system, we need a much more unified effort, in which we all continuously take part.

Recommended direction for reforming the international financial architecture

Strengthening the international financial system requires, among others, implementation of international standards and codes, as stressed by Minister Eichel. But I would also like to suggest that advanced countries play a more active role in supporting the efforts of developing countries.

Having said that, allow me to recommend a way to further reform the international financial architecture from the perspective of emerging market economies.

Addressing the problem of speculative short-term capital movement

First of all, industrialized and developing countries must work together to develop regulatory measures to address the instability caused by speculative short-term capital flows.

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In doing so, capital-importing economies can improve their ability to monitor short-term capital inflows. They can also implement prudential regulations on managing external liabilities. Moreover, a regional monitoring system should be established to better deal with speculative capital flows in this region.

We also need to consider establishing an effective Early Warning System to help prevent the currency crisis and a proper Surveillance System to better monitor regional economic and financial developments. I welcome the recent discussions taking place on these initiatives in East Asia. And, in the medium term, we could consider expanding such systems that are connected to Europe under the ASEM framework.

At the same time, capital-exporting countries must develop systems that hold private investors responsible for their investment decisions, making sure that they are fully aware of the risks and rewards.

We should also explore direct regulations on Highly-Leveraged Institutions, as suggested by President Kim Dae-Jung and agreed by ASEM Leaders at the last ASEM Summit in Seoul. In addition, there is a growing tendency that speculative investment seeking short-term returns is not confined to hedge fund and is expanded to other traditional financial institutions. Therefore, it is necessary to address these issues from the broader context of reinforcing appropriate supervision, enhancing prudential regulation, and the principle of equitable burden-sharing.

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Stabilizing exchange rates among the anchor currencies

Secondly, we must work together to reduce volatility of exchange rates between the major currencies. Large swings in the value of key currencies, as we have observed in recent months, induce comparable sudden changes in capital flows and thus destabilize international financial markets. The instability of global markets also constrains growth of international trade and investment.

To cope with these challenges, we should adopt an adequate foreign exchange regime, consistent with macroeconomic policies in place. Likewise, monetary and financial cooperation at the regional level needs to be enhanced for the stability of exchange rates.

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But more crucial will be the stepped-up joint efforts on the part of advanced countries themselves to bring about greater stability in the major currencies.

Considering orderly and sequenced capital account liberalization

Thirdly, when pursuing capital account liberalization, we should always take heed of countries unique economic circumstances and financial market factors.

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As we all know, liberalization measures serve highly desirable objectives. However, studies indicate that should liberalization not be carried out appropriately, it could be very costly.

Hence, if policymakers want to implement liberalization measures successfully, they should meet some pre-conditions such as efficient prudential regulatory and supervisory system, among many others.

Because these conditions cannot be fully met in a short period of time, carrying out orderly and well-sequenced capital account liberalization is essential for success. Moreover, the consensus views emanated from our discussions of the new architecture must be incorporated in the related programs of international economic organizations such as the OECD and the UNCTAD.

Expanding the participation of emerging market economies

Lastly, in the spirit of fair representation and creating an international financial architecture that is truly global and just, the views of emerging market economies must be sufficiently reflected in the policy-making process.

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ASEM, APEC and G-20 serve as good venues for representing the perspectives of emerging market economies. But the membership limitations at international financial institutions, such as IMF and the Financial Stability Forum, do restrict the reception of diverse opinions.

Given the growing influence of emerging market economies in an increasingly integrated world economy, the role of these economies at international financial institutions should be strengthened. In addition, their evolving positions must be reflected in the quota system within the IMF and the World Bank in the near future.

The participation of emerging market economies in the working group of the Financial Stability Forum could also enhance the forums legitimacy, since these countries are systemically important to the Forums mandate. VIP