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Mechanism to monitor capital flows needed

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Q: How will the proposed free trade arrangement between South Korea and Japan affect Japan's relations with its trading partners in South-East Asia?

A: There has been tremendous improvement in Japanese-South Korean relations in the last year or so. We had some unfortunate history and we are able to put the past behind and work closely to build the future relationship. It is primarily due to the leadership of Kim Dae-Jung. We should build on it with South Korea playing a significant intermediary role between Japan and China. Relations with South Korea are significant and the rest of the region is also important to Japan.

We need to develop similar arrangements with Asean. But Asean has various degrees of development within the region. Ways of dealing with it (Asean) need to be contemplated very carefully. But if we could start our regional arrangement with Korea and Asean simultaneously and try to coax China into it slowly. This would be very good for the region.

Q: Is this not something that Dr Mahathir had suggested in 1990 - the EAEC which was very strongly and vehemently opposed by the US. Would not the moves receive the same opposition again?

A: We need to be careful. It (US) is still a hegemonic power in the world. Without antagonising the US too much I think the US should understand that the Europeans have a regional arrangement and the US itself has regional arrangements in the Western hemisphere. So it is only natural for Asian countries to have a regional arrangement which is not inconsistent with the global arrangement. We could persuade the US. We need to.

Q: The recent crisis has shown that the region must cooperate and work together for its own benefit. Could this be a stepping stone to make the US understand and appreciate that the region needs to work together for the benefit of the world economy and for the betterment of the US as well?

A: I think so. I could give you my experience. When I proposed the Asian Monetary Fund, the US strongly opposed it and virtually squashed the idea. But a year later we came up with the Miyazawa Initiative which is a bilateral initiative on the part of Japan and we did not hear strong opposition from the US on this initiative. Of course we talked fairly extensively with the US and insisted that it is the sovereign right of Japan to help countries in Asia and that should eventually benefit the US as a whole. So US did not oppose. From my experience, with careful persuasion and discussion it is possible to build a regional arrangement without very strong opposition from the US.

Q: It has been said that the US did not oppose the Miyazawa Initiative as one year later Russia was a problem and the US woke up and said Yes we need Japan to play a more important role in resolving the crisis or the US economy too would have been badly affected. The lack of opposition was more of self interest rather than the interest of Japan or of South-East Asia.

A: That is true to some extent. But nations of the world base their policies on some selfish interest and you need to take advantage of that. Timing is everything. That is true of Japan and that is true of Malaysia as well. At least practically we have some selfish interest and so has the US and one needs to take these into account.

Q: So where does the Miyazawa Initiative go from here?

A: Eventually it would develop into some kind of regional arrangement. How

that comes about is something we need to contemplate very carefully. One evolution taking place is that Japan is trying through the Miyazawa Plan to create a regional securities market and in order to enhance that market we are providing some partial guarantee on securities issued by the Asian countries. The Miyazawa Initiative is just a starting point. There could be various other developments and Japan should continue to provide the necessary funds particularly because we are recovering and these efforts need to be continued.

Q: During the recent crisis the banking sector was singled out as a problem. Japan has gone through various stages of development and there were NPLs (non performing loans) in the Japanese system. What lessons can countries like Malaysia, Indonesia and other crisis hit countries draw from Japan NPL lessons. What needs to be done?

A: Malaysia has less of a problem compared with other countries on NPLs and banking. But you need to be very careful when you liberalise the capital account. You need to have a very strong and competent Central Bank supervising your financial system. It is not only the developing countries, the developed countries, Scandinavian countries, the US and Canada among others, have experienced banking problems in the past decade.

Due to, what I call, the "cyber revolution" that is taking place, banking flows and capital flows has become increasingly rapid and huge in magnitude. There is a need to develop a mechanism to monitor them. If necessary to control them. It is a challenging task not only for the developing countries but for the developed countries as well. We need to build national and international mechanism to monitor those flows well. Bank Negara has done a good job during the course of the crisis.

We (Japan) had a very severe banking and financial crisis in 1997 and 1998. We are now recovering from it. But we need to be vigilant. Even though discussions on the international financial architecture have started among the G-7 and G-20 but so far nothing much has been achieved. And the crisis could occur in future. We need to build some self defence mechanism.

If the global mechanism is not completed as we wish, we need to build national defences. A national defence mechanism would need to have a good national supervisory authority. You need to build up foreign reserves, you need to build up some kind of contingent arrangements with the private sector and need to develop some kind of regional arrangement to forestall the crisis. And if the crisis takes place to provide reciprocal financial arrangements. These things need to be developed.

If a global lender of last resort could be developed, with some agreement with the nations of the world, that would be the best. But that is almost impossible. So we need to build national and regional defences against future crisis.

Q: Do you envisage countries in the region, perhaps led by Japan, setting up some separate mechanism or system such as the Asian Monetary Fund (AMF)?

A: We need to work very carefully. But some such arrangement would be necessary. Japan should not take a hegemonic role in it. It needs to be developed with Asean, China, South Korea and possibly with India in some cooperative manner. The EAEC which was proposed by your Prime Minister some years ago must be perceived by countries in the region in a constructive manner.

Q: What difference would EAEC have made if it had existed during the recent crisis?

A: If EAEC or AMF (Asian Monetary Fund) was established in the fall of 1997 the situation could have been different. As a matter of fact, at the initial stages of the crisis, the International Monetary Fund (IMF) made

several crucial mistakes in Thailand, in Indonesia and in South Korea. Eventually they modified the initial position as things evolved in 1998. But the initial mistakes committed by IMF in late 1997 and early 1998 were very crucial - tightened the monetary policy which was not necessary, imposed very rigid and sometimes unrealistic structural reforms in a somewhat unreasonable manner. It was too hasty.

Structural reforms in Asia may have been necessary but it should not have been imposed from outside without internal preparations for the change. Malaysia did that voluntarily after imposing capital controls. South Korea has done that after the imposition of the IMF programme in improving the position of the chaebols. Ownership is very important and domestic political consensus is extremely important to implement reforms.

Q: It appeared as though the IMF was moving, in the initial stages, away from its defined role to pricing open the markets instead of dealing with the crisis.

A: I think so. I think the IMF started to take that kind of position in the early 1990s when it started to deal with the Soviet Union. But as Martin Feldstein of Harvard has argued these are not the appropriate functions of the IMF. The IMF needs to concentrate on macro policies and liquidity issues rather than structural problems. Too much emphasis was placed on structural reforms. That does not mean that structural reforms were not necessary but it was not the function of the IMF to impose those reforms on the countries in crisis. In some cases that precipitated the crisis rather than halting the crisis.

Q: The IMF seems to have an almost "clean record" of disaster wherever it has gone to assist - in Latin America, Africa and now in South-East Asia. It does not say very much for the success of IMF and yet nobody, not even the major players and decision makers in IMF want to change the IMF.

A: It (IMF) needs to be changed. Two things need to be stressed in fundamentally reforming the international financial architecture.

One, is what I call, localisation. They need to know the countries that they are dealing with much more than they do at this moment. They need to know the history, they need to know the political structure, they need to know the institutions. In order to do that they need to station more people in the developing countries. Jim Wolfenson (World Bank managing director) has done that in the World Bank and now the World Bank vice president in charge of the country, under normal circumstances, stays and lives in that country. That kind of localisation is absolutely necessary for the IMF if it continues to deal with developing countries.

Second, their dogmatic approach, which could be called a monetary approach to the macro economic issues, has been too rigid. They need to take a more flexible and pragmatic approach to the policy issue they are addressing. This dogmatism of the IMF monetary system has not been helpful.

Q: But how do you change the IMF when major powers including people like Larry Summers (US Secretary of the Treasury) are not keen to change?

A: Larry Summers could be persuaded. He has, as a matter of fact, come up with a reform plan for the IMF. Yes, he is now emphasising that IMF should limit its role to macro economic and liquidity issues. That I think is the right approach.

I see it as a positive move. Even though no agreement (for the proposal) has been secured at the Group of 20 (G-20) meeting but it is moving in that direction. That is progress.

Q: Asean has said that it would support your candidacy for the IMF managing director's post. But you have not said whether you agree to be a candidate. You have been silent on it. What is your stand?

A: I am aware that the Japanese Government is considering putting me up as

a candidate and they are sounding the possibility in various forms. I have not been formally asked. But it is my feeling that it may be very difficult at this juncture for Japan or for any other Asian country to get that position. It has traditionally been a European position and unlike the UN organisation it is not a one country one vote system in the IMF. It is a weighted voting system. If the Europeans and the Americans agree that's it.

At this juncture it is meaningful for any Asian country to show its willingness for that position and to argue that the position should not be monopolised by Europeans and I believe that is the intention of the Japanese Government's initiative.