



ROAD TO SEOUL

“Mitigating Risks in the International Financial System: National, Regional, Global Responses”

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*Kenney Auditorium
Johns Hopkins University – SAIS
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WELCOMING REMARKS

Thomas Hubbard: I'm chairman of the Advisory Council at this U.S.-Korea Institute at SAIS. On behalf of U.S.-Korea Institute, I would like to welcome all of you here today for this very important program. As I went through the room this morning, I felt like I had entered into some kind of special fraternity or sorority; a group of people who had been working with each other in various settings including: recently in Kwangju, all for a very important purpose of making this G20 exercise this year a success. All of you know a lot more about the G20 and the objectives than I do. I hope to learn some things as I join you for part of the meetings today. But I thought I would just start by saying this is a very unusual event for us at U.S.-Korea Institute. We usually do events relating to the U.S.-Korea Free Trade Agreement, and events relating to North Korea. I think this is the first time we here at this institute have hosted an international, multilateral meeting of this kind.

I am very pleased and honored to open this meeting. I have said throughout the past year or so in meeting with Americans, that we are very lucky that a non G8 country for the first time is president of the G20 process and hosting the meeting. We are lucky that it's Korea because Korea has been such a success as an economy. And that's due to the efforts of people like Ambassador Han Duk-soo, who must feel very much at home here as a former finance minister. And people like Je-Yoon Shin who is spearheading this operation. I look forward to a good meeting. I think we all look forward to a successful G20 in Seoul. I am happy to welcome you here. Ambassador Han.

Han Duk-soo: Thank you, good morning, Tom for your kind remarks. I would like to thank Executive Director Marc Uzan for arranging this event and inviting me to participate. As the global economy has become more integrated, damaging events like the 1997 Asian currency crisis and the U.S. financial crisis of 2009 have gone viral. They spread alarmingly fast and affect markets and economies worldwide. Since the Asian crisis, financial contagion has come to be understood as a key factor threatening the stability of the global economy. During the recent crisis, the affected emerging market countries including Korea, responded through domestic policy actions. They used accumulated reserves to help lessen the impact of the shock. But in most cases, this was only partially effective. Several countries also needed to rely on external cooperation including: central bank swap lines, precautionary finance from the IMF in the form of newly developed flexible credit line, or traditional IMF lending through a series of standby arrangements.

Based on these experiences, the G20 has recognized the potential of increasing capital volatility to pose a serious risk to the global economy. And, as a part of these efforts to pursue sustainable growth, it has agreed to develop ways to help countries deal with such problems. In this context, Korea has listed the strengthening of global financial safety nets, or global financial safety net as a major item on the agenda for the G20 Seoul Summit.

The GFSN should be built on four principals: certainty, sufficiency, freedom from stigma, and minimization of moral hazard. These principals are important because an effective GFSN must work as a forward looking crisis prevention mechanism rather than a crisis resolution mechanism. Further, in order to meet the various needs of countries as they confront varying situations, the Global Financial Safety Net should be a multi-layered network of facilities: National, Regional, and Global.

The national layer should have each country deploy potential macroeconomic policies to prevent the contagion of internal financial and economic problem. Effective national economic and financial policies provide a first and most important line of defense for countries facing external shocks. If needed, a bilateral swap line could be considered to stabilize the financial markets. However because they are at the discretion of the issuing central banks, bilateral swap lines are not considered an effective financial safety net.

The second layer comprises regional financial safety nets. Regional arrangements in Europe were established in response to developments in the Euro area financial crisis. In the Asian region, the Chiang Mai Initiative of the ASEAN plus three countries has expanded into the Chiang Mai Initiative multilateralization. We need to find the most effective way for the IMF and regional alliances to cooperate through coordinated surveillance or co-financing.

The third layer consists of global financial safety nets. The IMF's variously credited provision facilities make up the global layer of the global financial safety net. Although the IMF has tool kits such as the flexible credit line, some countries feel the current FCL is not sufficient in view of the critical global financial safety net principles I mentioned. In this context, the IMF recently decided to reinforce its current lending facilities. Through close cooperation between the G20 countries and the IMF, the IMF's executive board decided in August to increase the duration of and credit available from the flexible credit line and to establish the precautionary credit line.

As mentioned by IMF Managing Director Dominique Strauss-Kahn, these decisions will expand and reinforce the IMF's crisis prevention tool kit and mark an important step in this ongoing work with its

member countries to strengthen the global financial safety net. The FCL created in early 2009, has provided access to IMF resources for countries with very strong policies without time potential disbursements to traditional ex-post IMF conditionality. The IMF doubles the flexible credit lines duration to two years with a midterm review. At the same time, the access amounts available under the FCL were made more flexible by removing what previously had been an implicit cap of one thousandth percent of the IMF quarter. The new precautionary credit line or called PCL, was designed for countries that have sound economic policies, but that still may have some moderate vulnerabilities that need to be corrected by policy adjustments. The PCL will serve countries that seek insurance against financing shocks, and that have been vetted through a process of qualification that is similar to that for the flexible credit line.

This new precautionary credit line also features streamlined ex-post conditionality, monitored through semi annual reviews by the IMF board, and focused on reducing vulnerabilities identified in the qualification assessment. As the chair of G20's Seoul Summit, Korea welcomes the International Monetary Fund's measures to expand and enhance its lending tools to help prevent financial crisis. However, we need more efforts toward crisis preemptively and to reign in subsequent post-facto propagation. By the November Seoul Summit, emerging market countries, including Korea, hope to see more progress for the global stabilization mechanism which is under discussion within the G20 and the IMF. The global stabilization mechanism is to be a comprehensive liquidity supporting framework for use in the event of a systemic crisis. To achieve this goal, the G20 countries plan to discuss additional measures to enhance global financial safety nets in a series of meetings this fall. For that, we need more cooperation between regional financial safety nets and the IMF.

Today's seminar is a valuable opportunity to share and disseminate the idea of global financial safety nets among leading scholars, and senior officials around the world. Let me now end my remarks by wishing the seminar all the success. I will be looking forward to the seminar proceedings. Thank you.

Marc Uzan: Good morning. I will be very brief, as we already are running late. Just two or three remarks for us to thank all of you for having accepted to participate in this seminar. This is the second in a series in fact on the issue of Global Financial Safety Net. Reinventing Bretton Woods first did its first meeting in Incheon, Korea before the G20 deputies last February where we started to look at this issue very specifically. And during summer time, we suggested, in fact the U.S.-Korea Institute suggested that it would be a very good idea to work together to put together this seminar just after the G20 deputies meeting that took place this weekend in Korea.

The timing is also good because the IMF just announced two weeks ago the establishment of a new precautionary credit line. So in terms of timing, hopefully we can come up with better insight and hopefully helping the Korean delegations before the G20 summit in Seoul, and of course, the next month's IMF meeting.

I would like to give a couple of words just from our side as Reinventing Bretton Woods. This is the work that have been doing over the years. We just hosted also with the G24 meeting on private capital flow in Peru two months ago. So all the papers are available on the website. And last but not least, after Korea, France will be chairing in the G20. And one of the many priorities for France next year will be the reform of the international monetary system, who will prepare a seminar with the French authorities on this issue in December.

Let me thank our partners here at the U.S.-Korea Institute and Mr. Jae Ku and his team for having accepted to work with us and asking us in fact to work with them. And also the Korean delegations who flew after the deputies' meeting. I am very pleased as to Mr. Shin, Mr. Choi and his delegations that are here today. So Mr. Shin was being quite instrumental on all this work, architecting and making sure that the G20 Summit in Seoul is a success. He has agreed to speak and provide us some remarks about what we can expect and where we are not only on the financial safety net, but also maybe on the mutual assessment framework, and also how the transition will be moving forward between France and Korea. Thank you.

OPENING ADDRESS

Je-Yoon Shin: Good morning ladies and gentlemen. The honorable Thomas Hubbard, the Chairman of the U.S.-Korea Institute at SAIS Advisory Council. And his Excellency Han Duck-soo, my former boss and Korean Ambassador to the United States of America. And my dear friend Marc Uzan, the executive director of the Reinventing Bretton Woods Committee. And distinguished participants, and ladies and gentlemen. It is my honor to speak before you today as the Chair of the G20 Finance and Central Bank Deputies process. I would like to briefly cover two things. First I will briefly introduce the G20 as in for the Seoul Summit in November. And then I will focus on today's topic of financial safety nets and outline what the G20 has done so far and what it still needs to do. Hopefully, this will provide you with a broader context for today's discussions.

While at the Pittsburg Summit, G20 was designated as the premier forum for international economic cooperation. So far, G20 has gained a good reputation. There are high expectations, especially for the Seoul Summit. And agenda for the summit, it's truly formidable. For example, in Seoul, we must deliver a crisis-proof financial system with new capital, liquidity and leverage standards, and with new measures to deal with the systemically important financial institutions. In Seoul, we must also deliver a shift in the IMF quota share of at least five percent. This will finally fulfill the G20's commitment to improving the credibility, legitimacy, and effectiveness of the IMF. This will also be a very symbolic achievement for the Seoul Summit. In Seoul, we must also continue to implement the framework for strong, sustainable and balanced growth, and deliver ambitious and yet realistic policy recommendations at the country level. These will represent a comprehensive action plan by the G20.

But these are not all. The Seoul Summit is the first meeting held in a non-G7 emerging country, as former Ambassador Hubbard recognized. And it is being chaired by a country which quickly became an advanced country from an underdeveloped country. That is Korea. Therefore, there are even higher expectations among non-G20 countries. Korea cannot shy away from these expectations. Korea is well positioned to bridge the gap between advanced and emerging economies.

So with this in mind, Korea saw the need to add two additional issues to the G20 agenda. These issues are the financial safety nets to mitigate the risks in the international financial system particularly for emerging countries. And development of low income countries to generate additional demand, identify new growth engines and help achieve balanced and sustainable growth. These two issues are not only for the emerging countries but also for advanced countries. After much discussion and debate within the G20, these two issues were formally just added to the G20 agenda. Therefore in Seoul, we must also deliver a development framework and multi-year action plans for the G20.

As for the global financial safety nets, this is a very emotional issue for me. So I would like to tell you a little about my experience, what the G20 has done so far, and what we'll need to do in the lead up to the Seoul Summit. Despite the fact that Korea had its house in order with very sound policy frameworks, Korea was still hit hard by the crisis. As the global deleveraging continued to take place at a rapid pace following the collapse of Lehman Brothers, Korea's foreign exchange stock and bond markets were also hurt from rapid foreign capital outflows. We saw about sixty billion U.S. dollars being taken out of Korea in just six months. Korea's export volume fluctuated by thirty percent a day at the peak of the crisis. And while we had 260 billion dollars in our foreign reserves, it was still not enough to calm the market.

I was in the middle of this chaos. I had to experience first-hand the sadness of the being small open economy. And I had to think and work fast to come up with solutions. Among many things, bilateral sub-arrangements with the U.S., China, and Japan proved to be the most effective in stabilizing the market. So that's why I want to emphasize these kinds of backup facilities, especially in the financial market. Many emerging and developing countries experienced similar difficulties as Korea. For countries with non-reserve currencies, the volatility in their financial markets developed into a liquidity crisis. The domestic economies were endangered. The whole experience made us realize that if we do not strengthen backup facilities, it would be difficult for emerging and developing countries to confidently and actively participate in globalization. We also realized that the communication with the market is extremely important as lots of these volatile movements were based on pure market sentiments. So the issue was put on the G20 agenda. And our financial safety net expert group was established under the co-chairmanship of the UK and Korea. And since then, the G20 has had lots of very useful discussions about this issue, and achieved some good outcomes.

As Ambassador Han mentioned earlier, the first set of concrete outcomes was just announced by the IMF two weeks ago. The Fund has decided to enhance the crisis prevention tool kit by enhancing FCL—flexible credit line and establishing a precautionary credit line—PCL. I do very much welcome the IMF's quick response to the G20's callings. However it is too early for us to fall into complacency. I believe that a desirable global financial safety net system should include various options so that countries can choose the one that best fits their unique circumstances. Also there is still a threat of stigma that might hamper countries from accessing IMF instruments at earlier stage. In addition, a firewall against crisis contagion, should a global systemic shock occur, must be further strengthened.

This is why our discussion today is so timely. Your views and suggestions will be incorporated into our thinking so that in Seoul we will be able to deliver on a set of concrete policy options, based on sound incentives, to strengthen the global financial safety net as mandated from our leaders. I am also interested in communicating with you so that we can better understand the purpose of global financial safety net and its likely impact on the market behavior. Once again, thank you for the opportunity to address you this morning. I look forward to our discussion today. Thank you for your attention.

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