Seung Park: Economic and financial developments in East Asia

Introductory remarks by Dr Seung Park, Governor of the Bank of Korea, at the International Forum on Monetary & Financial Cooperation for Asia, Seoul, 20 February 2004.

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Opening remarks

Ladies and gentlemen,

Let me first extend a hearty welcome to all participants who have gathered from Australia, China, Japan and Korea to attend *the International Forum on Monetary & Financial Cooperation for Asia*. I am very glad to see here today so many great scholars of money and finance.

I would especially like to express my deep thanks to Prof. *Choi, Woonyoul*, President of *Korea Monetary and Finance Association*, and all those involved with arranging this meaningful and timely forum for having invited me to address you today. Prof. *Choi* was one of the *Monetary Policy Committee* members of *the Bank of Korea* until the end of last year and contributed greatly to the Bank's conduct of monetary policy. Taking this opportunity I thank him again for all his services during his terms of office.

The finance associations of the four countries taking part in this forum have been engaged in very lively research activities and academic exchanges that have contributed mightily to financial sector development not only of their own countries but of entire Western Pacific Basin region.

Your forum is also the focus of attention because discussion will center mainly on a matter of common concern throughout East Asia, namely on plans to promote regional cooperation for the growth of the financial sector.

The position of East Asia in the world economy

Ladies and gentlemen, as you are well aware, East Asia has achieved very high rates of economic growth over the last half century, and is now a major pole of the global economy.

Japan long ago joined the ranks of advanced countries after the post-war reconstruction of economy. Korea, for its part, achieved *the Miracle of Han River* rising phoenix-like from the ashes of the Korean War and utter destitution to become a member of what is often called the rich man's club of the OECD in 1996. Since the 1980s, China has also maintained rapid growth averaging around 9% and paved its way as a great new economic power. As a result, East Asia's economic profile has been greatly heightened. Japan, China and Korea now rank the 2nd, the 6th and the 12th country respectively in terms of the scale of their economies with the combined GDP of three countries representing 18% of that of the world as a whole.

In the course of its dramatic economic spring forward, East Asia has accumulated immense foreign reserves. As of the end of last year, the foreign reserves of Japan, China and Korea amounted in all to some 1.2 trillion dollars. The total when those of Taiwan and Hongkong are added in, makes up half of the world's foreign reserves. East Asian reserves have been mainly invested in U.S Treasuries. This means that a large proportion of the American fiscal and current account deficits is financed by the East Asian countries.

Fragility of the financial sector in East Asia

Despite the dramatic growth in the real economy, the East Asian financial sector trails those of the U.S and Europe.

The Japanese financial industry was once the world leader in terms of scale of financial assets. It proved unable, however, to adapt itself to liberalization and market openness. Its structural fragility was laid bare resulting in the protracted recession of last decade.

After the foreign currency crisis in 1997, the Korean financial sector turned its back on the old system and achieved a rebirth through thoroughgoing structural reform. Nevertheless the soundness and profit of financial institutions worsened again last year in line with the rise of household insolvencies.

The troubled status of some credit card companies still remains a big problem, which destabilizes the financial market and is one cause of the subdued state of domestic demand.

In the Chinese financial sector, it is said that there is still much room for improvement in terms of the legal and institutional infrastructure. Notably, in the process of rapid economic growth, the banking sector expanded loans to state companies so rapidly that they hold a great stock of non-performing loans. This overhang represents a latent threat that could hold back the sustained development of the Chinese economy at a later stage.

Need for financial upgrading and the strengthening of cooperation in East Asia

Without financial stability and development, it is unreasonable to look for continuous growth of the real economy. Examples spring all too readily to mind.

The Korean economy, after long maintaining its rapid growth pace, was hit by a foreign currency crisis and a deep recession at the end of 1997. The accumulated structural fragilities of the financial sector were revealed all at once. For its part, Japan endured a long recession for more than 10 years after the bubble burst in the early 1990s.

In East Asia, along with the brisk growth of the real economy, financial demand has also been increasing sharply, in connection with trade, foreign direct and indirect investment, and the operation of the foreign reserves. Looking only at trade, the volume between Japan, China and Korea built up rapidly from 96 billion dollars in 1990 to 378 billion dollars in 2002. The regional financial demand accompanying those trade flows has seen explosive growth.

Nevertheless, because of the fragility of regional financial structures, U.S & European-based investment banks meet a large part of the regional financial demand through their advanced financial systems and accumulated expertise.

This is why East Asian countries must cure the fragility of their financial sectors and strengthen financial cooperation within the area. Notably East Asian financial markets are relatively narrow so that they are easily liable to attacks from large flows of speculative capital. Worse still, with the progress of financial liberalization and openness, financial unstability in one country spreads instantaneously to other associated countries. In the light of this situation, close financial cooperation is more urgent than ever.

Encouragingly several steps have been already taken to strengthen regional financial cooperation. In May 2000, the members of ASEAN+3 opted for the *Chiang Mai Initiative.* This is based on the provision of bilateral liquidity support through the arrangement of currency swaps between the central banks involved. The Bank of Korea has regular conferences on matters of mutual interest with *the Bank of Japan* and *the People's Bank of China*. Beside this, it opened a *Beijing* representative office last November with a view to intensifying cooperation.

These steps, I think, are only just beginning. It is absolutely vital that we continue to expand such financial cooperation throughout the region.

Closing remarks

Given the increasing necessity of financial cooperation among regional countries, Korea, China and Japan have recognized the building of an East Asian financial hub as a core task for economic development. There is rivalry among them for it to be built in their own countries. Such competition, however, does not mean the exclusion of others. Rather competition in good faith can provide opportunity for the financial markets of each country to overcome their structural fragility, and develop together. In this way it, in fact, promotes mutual cooperation.

Your conference offers a valuable chance in this respect to expand financial cooperation by widening the breath of mutual understanding through the sharing of ideas and opinions among experts.

My especial hope is that we will find a basis for specific and practical initiatives in deep and wide-ranging discussions about East Asian monetary integration and the development of Asian bond markets, both matters that are the focus of intense debate these days.

Fruitful outcomes from this conference will be a great boost to financial economists. More practically they will be of immense help to administrative authorities like governments, central banks, and financial supervisory institutions and to financial players like banks, insurers and securities companies. In this respect I have great anticipations of this conference.