

*Remarks as Prepared for Delivery –
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Evolving Regional Frameworks and Global Challenges: Korea's Perspective

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Before presenting my views on the subject, I would like to thank the Bretton Woods Committee for inviting me to speak at this international council meeting.

Regional frameworks: potentials and limits

Let me begin by discussing the potential, as well as the practical limits, of Asia's current regional framework as a collective insurance mechanism for preventing crisis. Asia's regional framework, developed under the *Chiang-Mai Initiative Multilateralization*, is intended primarily to facilitate liquidity risk pooling at the regional level. As we know, the efficiency gains from risk pooling increase with the number of individual risks to be pooled and the less positively correlated with each other these individual risks are. Regional risk pooling should in principle therefore be less efficient than global risk pooling.

As such, Asia's regional framework may be considered less effective than originally hoped, because the Asian economic and financial cycles are synchronized, and because they are collectively vulnerable to common global financial shocks given their heavy dependence on the US dollar in international trade and finance.

In reality, however, there are many other factors that might affect the effectiveness of a regional framework. I will focus here on two of them, which I believe to be highly relevant in the Asian context.

The first is the strong trade linkages among Asian countries. Intra-regional trade accounts for more than one-half of Asia's total trade. This fact will then imply a high likelihood of real contagion across countries in the region. If Asia's regional framework can help to stop contagion before it spreads, it would be valuable.

The second is the governance structure of global risk pooling, as currently organized by the IMF. Many Asian governments have been averse to receiving financial assistance from the IMF—mainly because of the politically unpalatable stigma effects. Moreover, they appear less assured of the transparency and uniformity of IMF decisions regarding conditionality and financial support, and of the fair representation

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of their own voices in the IMF decision-making process as well.

During the global crisis, no Asian countries tapped IMF resources made available to qualified members, even though the terms were very favorable and there was no ex post conditionality attached. This could of course be an indication that liquidity shortages among Asian countries were far less severe than they appeared at that time. Nonetheless, I believe they would have utilized these IMF resources for precautionary purposes, had there been no fear of stigma effects.

Building a multi-layered system of financial safety nets

Having said all of this, I would like to move on to the issue of how to build an efficient system of global financial safety nets that offers good protection to countries while minimizing moral hazard. My views here may be speculative, given the complexity of international coordination of national interests and the limited availability of empirical evidence on the effectiveness of safety nets. Nevertheless, I hope that I can offer some good food for thought.

To summarize, I believe that we need a multi-layered system of global financial safety nets, with the IMF taking center stage in the system to capitalize on the potential efficiency gains from global risk pooling. The various regional frameworks could then be nested within the global pool. Under such a system, a global crisis would be dealt with primarily through the resources of the global pool, while the regional frameworks would focus on individual home-grown crises triggered by idiosyncratic shocks. Such a dichotomy would not have to be absolute, however, and some overlapping in roles would be necessary and even desirable.

In order for the IMF to play the central role in this system, its resource base for lending would need to be increased and its governance structure improved. In this regard, there has been considerable progress in recent years, and further progress is within sight in the G20 process with regard to IMF quota reform. As part of our contribution to the global safety nets, the Bank of Korea recently committed US\$15 billion to the IMF under the bilateral borrowing agreement.

Nesting the regional frameworks into multilateral efforts for crisis prevention is of course no easy task, and would require clever thinking on the design of conditionality and lending. I speculate that, if warranted, the IMF could lend to the regional frameworks which would in turn lend to their members in need. Alternately, both

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institutions may lend jointly to individual countries. A nested scheme is easier described than implemented, however. There are many technical but nonetheless critical issues to be tackled. For instance, who should own the conditionality of IMF lending to a regional framework —the regional framework itself or the ultimate borrower country? Who should be responsible for surveillance? And when multiple institutions lend jointly, whose money should receive seniority? I hope that the IMF will lead the research on the design and modus operandi of a multi-layered system of financial safety nets.

Greater role of major central banks

Finally, I would like to draw your attention to the complementary roles that major central banks can play in crisis prevention. While it is hard to predict with precision what any future global crisis will look like, we can say with some confidence that it will be preceded by pervasive global liquidity disruptions. In this light, and given that the IMF resources are limited, the major central banks should better serve as the international lenders of last resort. And we should work together to find ways of integrating their roles into the system of financial safety nets led by the IMF, while at the same time also not undermining their independence.

Thank you for your attention.