Sustainable Growth - Financial Stability

Current Lessons for Social and Economic Governance

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Preface

It is four years since so called the "Lehman shock" triggered the global financial crisis in September 2008 and the world economy is still under severe strain. Although much has been discussed ever since, few are expecting to see a stable and prosperous world just around the corner yet.

What actions need to be taken by governments, private companies or citizens in the advanced economies as well as the emerging economies? What lessons can be learned from previous and current economic and financial crises? How can our social and political ideals be redefined under the changing economic environment? Which models of social and economic governance can achieve sustainable growth and inclusive societies?

To address these questions, the Konrad-Adenauer Stiftung (KAS), the Institute for International Monetary Affairs (IIMA) and the Global Movement of Moderates Foundation (GMMF) held a symposium titled "Sustainable Growth - Financial Stability : Current Lessons for Social and Economic Governance" at Keidanren Kaikan in Tokyo on October 2, 2012. A number of prominent experts joined our symposium panel to share their views and opinions on these globally challenging issues. And the discussions were well received by an attentive audience.

We sincerely hope this record of the symposium will help to give you much inspiration in your professional considerations, may they be in the business, academic or political fields.

December 2012

Konrad-Adenauer-Stiftung Japan Office
Institute for International Monetary Affairs

International Symposium
Sustainable Growth - Financial Stability
Current Lessons for Social and Economic Governance

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Tuesday, 02 October 2012

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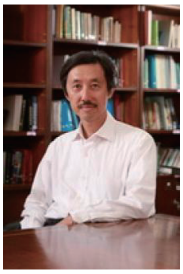
Speakers Profiles

Adek bin Hussin, Awang

Dr. Awang Adek bin Hussin is currently the Deputy Finance Minister of Malaysia. After the completion of his Bachelor's and Master's degrees in the USA, and a Ph.D., he started his career as a lecturer in economics at Universiti Sains Malaysia. Subsequently, he held several higher positions at the Bank Nagara Malaysia until he was appointed Deputy Rural Development Minister in 2004. From 2006 to 2008, he served as Deputy Finance Minister and was called back to serve again in this position in 2009.

Chirathivat, Suthiphand



Dr. Suthiphand Chirathivat chairs the Chula Global Network and teaches economics at Chulalongkorn University. He previously served as Dean of the Faculty of Economics and as Director of the Centre for European Studies. Furthermore, he held advisor positions at several Thai ministries and was a member of the APEC Panel of Independent Experts. Dr. Chirathivat represented Thailand in the East Asia Expert Study Group of ASEAN+3 until 2009.

Choi, Jong-Tae

Minister Choi was born on 25 November 1939. He earned his Ph.D. in Business Administration at the University of Linz, has been Professor (1976 to 2005) and Dean (1995-1997) at the College of Business Administration at and still is Professor Emeritus of Seoul National University. He served as Chairman of the Tripartite Commission Seoul Model from 2002 to 2011, and Chairman of the National Minimum Wage Council. Since November 2011, he has been serving as Chairman of the Economic and Social Development Commission. Minister Choi has received the Order of Service Merit (Aquamarine Stripes) in 2000 and Order of Service Merit (Yellow Stripes) in 2005.

Dieter, Heribert

Dr. Dieter currently serves as Senior Associate at the German Institute for International and Security Affairs in the Research Division on Global Issues. Furthermore, he holds posts at the Centre for the Study of Globalisation and Regionalisation of the World Economy at the University of Warwick since 2000, and is Adjunct Professor at the Free University of Berlin since 2006. In 2009 he was the Co-Director of "Warwick Commission on International Financial Reform". He is a member of the editorial boards of several major scientific journals.

Fan, Gang

Prof. Dr. Fan Gang currently serves as the Director of National Institute of Economic Research, as a Chairman of the China Reform Foundation and as Professor of Economics at Peking University and the Graduate School of Chinese Academy of Social Sciences (CASS). He is guest professor at a number of universities and graduate schools domestic and abroad, and served as the academic member of the Monetary Policy Committee of China's central bank 2006-2010. Prof. Fan is also a consultant to the Chinese government, The World Bank, IMF, UNDP, and OECD.

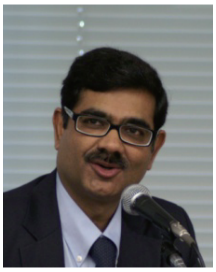
Fang, Nicholas

Nicholas Fang is the director of the Singapore Institute of International Affairs. He graduated from Oxford University with a Master in Politics, Philosophy and Economics, and worked as a journalist at The Straits Times for nine years, before taking on the position of business editor and presenter at Singapore's national broadcaster Channel News Asia. He was appointed as a Nominated Member of Parliament of Singapore in February, 2012. Mr. Fang concurrently holds positions as director of a private defence material agency and a sports consultancy firm.

Gyohten, Toyoo

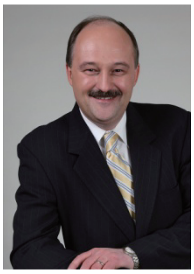
Toyoo Gyohten is President of the Institute for International Monetary Affairs. After graduating from Tokyo University in 1955, Mr. Gyohten joined the Ministry of Finance. After serving in a variety of bureaus including Banking and International Finance, as well as at many international organizations, he became Vice Minister of Finance for International Affairs in 1986. After retiring from the MOF he taught at Princeton and Harvard Universities in 1990 and was named Chairman of the Bank of Tokyo Ltd. in 1992. Since 1995 he has been at IIMA.

Kathuria, Rajat



Rajat Kathuria is Director and Chief Executive at Indian Council for Research on International Economic Relations (ICRIER), New Delhi. He has an undergraduate degree in Economics from St. Stephens College, a Masters from Delhi School of Economics and a PhD degree from the University of Maryland, College Park. His working experiences include the Telecom Regulatory Authority of India (TRAI), the University of Maryland, and the International Management Institute (IMI), New Delhi. He has also been a World Bank Consultant and received assignments from a number of organizations, including ILO, UNCTAD, LirneAsia, Ernst and Young, Consultancy Development Centre (CDC) and Standing Committee for Public Enterprises (SCOPE).

Meister, Michael



Dr. Michael Meister studied mathematics and informatics and holds a doctorate in natural sciences. He became a member of the Christian Democratic Union in 1991 and was first elected as a Member of Parliament in 1994. In 2000, he became a member of the Board of the CDU/CSU Parliamentary Group and served as chairman of its working group on financial issues from 2002-2004. Since then, he holds the position as the CDU/CSU Parliamentary Group's Deputy Chairman in charge of budgetary, financial, and local policies. Subsequently, Dr. Meister became a member of the CDU Federal Board in 2010. Furthermore, he is a member of the German Economic Council since 2007.

Mendoza, Ronald U.

Ron Mendoza is currently Associate Professor of Economics at the Asian Institute of Management (AIM), and Executive Director of the AIM Policy Center. Prior to his appointment at AIM, he was a senior economist with UNICEF's Policy and Practice Group in New York. In addition, his research background includes work with the UN Development Programme's Office of Development Studies, the Federal Reserve Bank of Boston, the Economist Intelligence Unit (EIU), and several non-governmental organizations in Manila.

Menon, Jayant

Jayant Menon is currently Lead Economist in the Office for Regional Economic Integration at ADB, where he works on a range of trade, international finance and development issues. Prior to joining ADB, he worked as an academic in Australia for more than a decade, having done research at Monash University, the University of Melbourne, Victoria University, and the American University in Washington, DC. He holds adjuncts appointments with the Australian National University, University of Nottingham and Cambodian Institute for Cooperation and Peace.

Nakao, Takehiko

Takehiko Nakao is the Vice Minister of Finance for International Affairs at the Ministry of Finance, Japan. After graduating from Tokyo University in 1978 (BA Economics), Mr. Nakao joined the Ministry of Finance and served in a variety of bureaus such as Tax, Securities, Budget, International Finance, before taking his present post in 2011. He also worked for the IMF from 1994 to 97, and served as minister at the Embassy of Japan in Washington, D.C. from 2005 to 2007. He obtained his MBA from the University of California at Berkeley.

Norzrul Thani, Nik

Dr. Nik Norzrul Thani is director of Al Rajhi Banking & Investment Corporation and chairs several public listed companies. Moreover, he is a Chairman and Senior Partner of the law firm Zaid Ibrahim & Co. He formerly served as Dean of the International Islamic University Malaysia and has been a visiting Fulbright Scholar at Harvard Law School in 1996/97 and Chevening Fellow the Oxford Centre for Islamic Studies in 2004/05. Dr. Norzrul got his Ph.D. in Law from SOAS, University of London.

Shiraishi, Takashi

Takashi Shiraishi is President of the National Graduate Institute of Policy Studies. After graduating and obtaining a MA in international relations, Mr. Shiraishi joined the University of Tokyo and was an assistant professor from 1979-87. Afterwards he obtained a Ph.D. in History from Cornell University and taught at the university until 1996. He became a professor of Southeast Asian Studies at Kyoto University in 1996, and became a professor and Vice-President of the National Graduate Institute of Policy Studies in 2005 before he was assigned to his current position in 2011. He has published many books, including "The Making of a Region" (2000).

Stanzel, Volker

Dr.Stanzel is the Ambassador of the Federal Republic of Germany in Japan since 2009. He studied Japanese and Chinese Studies and Political Science and received his Ph.D. from Cologne University. Dr. Stanzel joined the Foreign Service in 1979 and has worked at the German Embassies in Rome, Tokyo, Aden and Peking. From August 2001 until June 2002 he was Director for Asian & Pacific Affairs and from July 2002 until July 2004 Director-General for Political Affairs. In 2004, he assumed his position of German Ambassador to China and became Political Director in 2007.

Watanabe, Yoshihiro

Yoshihiro Watanabe is Managing Director of the Institute for International Monetary Affairs. After graduating from Tokyo University in 1970, he joined the Bank of Tokyo and served for many overseas businesses. He was the senior managing director of Mitsubishi UFJ Financial Group in 2005. He took his present position in 2008 and also chairs the Standing Committee of Japan-India Business Cooperation and is a member of the APEC Business Advisory Committee(ABAC), representing Japan.

Wolff, Jörg

Jörg Wolff is Resident Representative of Konrad Adenauer Foundation in Japan and Regional Representative for Economic Policy. Before joining KAS he served several years in the public service in Germany. He represented the foundation in six countries (Sri Lanka, Thailand, Korea, China, India, France) and got in between a secondment as Economic Advisor/Economic Councillor to the EU-Delegation/Embassy in Islamabad, Pakistan.

Opening Remarks

Toyoo Gyohten *(President, IIMA)***:**

Good morning, Ladies and Gentlemen. On behalf of the Institute for International Monetary Affairs, one of the cosponsors of this event, I would like to welcome all of you to this event. My first thanks must go to Mr. Volker Stanzel, Ambassador of the Federal Republic of Germany in Japan, who provided strong support from behind, with all incentives and encouragement and preparations for this successful meeting today. Also I am very happy and very much honored to have so many distinguished speakers today, including Mr. Michael Meister, Member of Parliament, Deputy Chairman for Finances and Budget, Germany, Mr. Awang Adek, Deputy Minister, Ministry of Finance, Malaysia, and also Mr. Jong-Tae Choi, Minister, Chairman, Economic and Social Commission, Republic of Korea and many others. Of course we have to thank a haze of other joint hosts, which are Mr. Jörg Wolff, Regional Representative for Economic Policy, Konrad Adenauer Foundation, Japan, and Mr. Khalek Awang, Chief Executive Officer, Global Movement of Moderates Foundation.

Well, Ladies and Gentlemen,

The global financial landscape is plagued by instability and uncertainty. I believe it is fair to argue that the global crisis which originated in 2007 in the sub-prime loan market in the U.S. was basically created by financial excess. The flooding liquidity spawned various bubbles, housing bubble, banking bubble, IT bubble, fiscal bubble, etc. depending upon the condition of each market. Inevitably, all bubbles are doomed to bust.

Toyoo Gyohten

-we have a new social class to be called "informed mass."

- the leader has to govern on the premise that everybody knows everything.

Unfortunately, in Europe, the financial crisis triggered the Euro-currency crisis unraveling the structural shortcomings of the Euro-system. When Europe celebrated the launch of the single currency everybody knew that there were still unfinished jobs. The job was to fill two gaps; the gap between monetary integration and fiscal non-integration, and the gap between the North and the South. I have to hasten to add that various efforts were made to compensate the defect, but unfortunately, these efforts were not enough. As a result, the Euro is now hanging over a cliff.

We have to acknowledge that European economy is badly hit. The European crisis gave rise to a credit crunch and a collapse of demand. In the globalized world, every corner was contaminated by such movements. The world economy is dampened. To that extent, it was an inevitable development.

I am afraid, however, that this time around the situation is more onerous. In addition to the ordinary economic damage the current crisis has aroused a wide range of grief and exasperation. People saw big banks were bailed out with tax money, and the guy who ran the bank fetched exorbitant remuneration. People saw the riches get richer and the poor get poorer, aggravating the social inequity. People saw elected politicians ruin national coffer while favoring vested interest groups. People saw a chronic decline of middleclass who supported a democratic society. In other words, the crisis exposed some fault lines which are running underneath our society. Disgruntlement about the future of market economy and democratic political system is on the rise.

What has caused the malaise? Was it the financial excess, flooded with greed? Was it the interconnected world? Was it the selfish and irresponsible voters? Was it the corrupt politicians?

I think all of them are relevant. We should not pretend that this is a misfortune somewhat like unpredictable natural disaster.

Then, is this a case of sickness of Western industrial world? Do they simply need to pay for their own profligacy? Indeed, particularly in Asia, there are intelligent people who complain that Asia was victimized by Western frolic. When they saw American and European economy damaged badly by a series of crisis since 2007, they argued, with quite a bit of schadenfreude, that the Western growth model proved to be a failure and they boasted the validity of Asian value or Asian way. Such argument certainly sounds sweat to Asian ears. The problem is, however, that nobody could ever define clearly what the Asian value is. The situation in many Asian countries such as China and India tells us that their growth models are also challenged. During the last couple of decades the world has enjoyed a certain degree of prosperity on a growing global imbalance which provided a precarious win-win situation for everybody. The global crisis which started in 2007 vindicated the fragility of the situation. The unsustainability of the traditional growth model in many countries both industrialized and emerging and the shifting balance of global powers are urging us to start exploring a new paradigm of social and economic governance, nationally and internationally.

During the period of transition the world will be faced with plenty of instability caused by conflict of interest. In order to prevent instability from exploding we need to learn the wisdom of fair sharing of power and responsibility.

In particular, industrialized countries have to learn how to share power with emerging countries in the global decision making process, and emerging countries have to bear due share of the burden of responsibility in the management of global issues.

In all societies in the world today, as a result of information revolution, we have a new social class to be called "informed mass". They can acquire information instantaneously, communicate each other instantaneously, and can let their voice heard throughout the world. The new situation is forcing a fundamental change of style of governance in all organizations including corporations, political parties and governments. In the good old days, the leaders of the organization did monopolize information, and the monopoly ensured the leader's authority. Now the situation has changed. The leader has to govern on the premise that everybody knows everything.

In the 21s century, the world is faced with many challenges, old and new. We have to explore ways to meet the challenges and survive the grilling period.

I believe we have a lot to discuss. Fortunately we have an excellent selection of the most qualified speakers. Enjoy the seminar.

Volker Stanzel *(German Ambassador)***:**
Ministers, members of parliaments, guests from abroad, and ladies and gentlemen, let me first of all thank you for joining this event. And let me congratulate the organizers, Mr Toyoo Gyohten and Mr. Jörg Wollf and others, for having the idea to host this, to organize it. It is a timely event. No, it would have been timely ever since the beginning of the world financial crisis. That is two years now, but let's say the problems have become ever more visible since the outset of the crisis. Now what is the crisis referring? I would say it is not the euro which is in crisis. If you look at the value of the euro now and compare it to the time when it was founded it is so much higher, which seems to confirm that as a currency it is stable. However, a problem is behind it. The problem of the euro crisis is exactly in the topic of today's symposium. The balance between sustainable growth and financial stability is what we Europeans have to learn seriously.

Look at the beginning of the last decade, from 2000 to 2006. We had more or less the same interest rate on the government bonds all across the Europe despite diverging development with debt stocks and competitiveness. But not until facing with Greek problem did investors understand that so-called bailout clause became a reality. And there would not be any automatic mutualization of liabilities. Since investors have come to realize it, we Europeans are confronted with the impatience of the financial market. The risks of specific countries came to be reflected in the risk premium much more than before. This is caused by the varying fiscal and competitiveness policies in member countries of the euro zone and the EU

Volker Stanzel
- mutualisation of risks might be an easier and painless way to solve the current crisis.

- but in reality it is going to lead us to the wrong way because underlying problems would not be solved.

Attempting mutualization of risks might be an easier and painless way to solve the current crisis from the point of view of the financial market. But in reality it is going to lead us to the wrong way because underlying problems would not be solved. This will weaken strong economies and damage their own growth clusters. This means losing overall competitiveness of the EU in the world market.

What really is needed is three fold strategy. First, we need substantive efforts of the crisis countries in order to regain debt sustainability and, more importantly, competitiveness of economy.

Second, we need a functioning crisis resolution mechanism so as to buy time, buy a breathing space for the weaker counties in order to alleviate the hardships they presently confront.

Lastly, we need further strengthening of European governance. Look at what has happened during the last two years. We all have managed strengthening European governance. That is deepening the integration of the euro zone, which used to be unimaginable only a few years ago. But we need to further strengthen that kind of effort to ensure consistent implementation of all the necessary fiscal and structural reforms.

Now the countries in the EU, especially the euro zone countries, have already made a significant progress during the last two to three years. Deficits declined by 2.3% of GDP on average. My country can aim now at structurally balanced budget by 2016 followed by other euro zone countries. In terms of competitiveness and current account balance, we see progress. Many countries embark on structural reforms that seemed impossible only two years ago.

Anyway, current account positions of deficit countries improved visibly. In order to take an objective view in comparison with the U.S., and if I am permitted to say so also in comparison with Japan, European figure and development are encouraging. But they have a downside effect on structural reforms, which is increasing unemployment. If you look at the latest figures, they are shocking in some of our counties. It is the process we have to go through, and hopefully, people in the countries concerned will continue to accept it in the way they did so far

Markets will continue to be careful. They are not yet completely convinced that all euro zone countries will stick to the commitment and further reduce the deficits, government debt stocks and increase competitiveness. Why? Confidence that has been lost cannot be restored overnight. We Germans know from the experience of the past six to seven years that regaining competitiveness is not easy. Necessary policy measures need to be constantly implemented over many years and this is painful. Europe currently goes through very painful period. We hope for the support of all partners including Japan. Thank you for all of you and hope for a successful symposium.

Session 1 - Retrospective: Economies in Turmoil?
Crises compared: Asia 1997/US 2008/Europe 2011 – Diverging Causes, Similar Dynamics, Same Effects?

Jayant Menon *(Lead economist, Trade Policy Team, Asian Development Bank/ Moderator)*:
Good morning, distinguished guests and Ladies and Gentlemen. I am pleased to be a part of this high level event dealing with a very exciting and topical issue which the global economy is facing right now. This session is supposed to look at three different crises: Crisis of Asia in 1997-98, the U.S. in 2008, and Europe in 2011.

Our first speaker today will deal with the Asian financial crisis of 1997-98. Let me briefly introduce Dr. Suthiphand Chirathivat. He is Chair of the Chula Global Network, concurrently teaches economics at Chulalongkorn University. He has previously served as the dean of the faculty of economics at Chulalongkorn University, and has held a number of advisory positions with the government of Thailand and has been a member of APEC panel of independent experts. Dr. Chirathivat was also a representative of Thailand in East Asia study group of ASEAN+3 until 2009. Please welcome Dr. Chirathivat to speak about Asia in particular and broader global issues.

Suthiphand Chirathivat *(Chairman, Chula Global Network, Chulalongkorn University)*:
The first thing that comes into my mind, is the fact that the present globalized world has crises of all sorts, man-made or not, including the repetitive and more frequent crises like the financial ones which we are all suffering now.

The ongoing financial crises have shown that the global financial system is unstable and the financial globalization simply puts existing governance structures one step behind. The process of globalization has arguably gone furthest in the area of finance. Financial flows travel around the world with increasing intensity and rapidity, looking for higher returns, with its "animal spirits" of the financial world. The public sector sees both benefits and risks of integration in globalized finance. Yet policy interventions, that have been accompanied with the liberalization of domestic financial markets and international financial transactions, seem to be inadequate and not matching well with private capital flows into and out of the country. We have much discussed the ideas of capital flows, following the Asian financial crisis. Now the subject is not limited only to

Suthiphand Chirathivat
- *To possess comparative strength and resilience, the region might need to reassess the model of external demand dependency.*

the Asian financial crisis, but covers all three regions facing with similar fates.

Then, there is also the issue about people, the general public at large. They like to blame economists, the professionals for not having foreseen how the crisis was unfold and blown. Even with the modeling-type studies, it seems unpredictable with regard to what had happened so far. Some even have gone far to blame the broader economic system, capitalism. It is probably true. We have to take the present crises in line with the logic of capitalism. We have to take that crises can happen more frequently, at any country, any time.

Those are my general observation. Now, let us turn to the discussion on crises from my perspective.

The case of Thailand is well known and quite illustrating. The overall macroeconomic environment looked sound with healthy fiscal proportion and reasonable foreign exchange reserves. However the country had fully liberalized the capital accounts in 1993 and our current account quickly turned into large deficit. By the crisis year, the amount of international private debts was three times the level of country's foreign exchange reserves, exceeding our capacities to service short and medium term debts. Then our country became a subject to currency attacks by speculators, leaving us into the crisis mercy. Similar experiences had happened in other Asian countries like Indonesia, Korea, Malaysia and so on.

Crises of the U.S. and Europe had shown a similar story. The subprime problems pointed not only to the overspending in the U.S. domestic market but also the problem of regulatory and supervisory systems. Europe's financial sector was so tied to the US subprime borrowings, in addition to the accumulated public debt; the Ponzi/Maddoff financial schemes were a wild fire that flared up very quickly following the subprime crisis of 2008 that led Europe to face first the immediate impact and to translate into a similar crisis of their own in banking and sovereign debt in 2011 and onward.

Comparing the impact of the Asian and global financial crises is not an easy exercise. However, we seek here to explain how and why the effects of these crises could be different when it comes to the way these countries need to respond from such an impact.

First, there is a major difference in the way we call the events of 1997/98 as a crisis "internal" to the region, by contrast, the financial turmoil in the U.S. 2008/09 as "external". The former should be called Asian financial crisis, while the latter, reaching many other countries, has been named global financial crisis.

Second, there was a clear "contagion" effect in which these three crises spread quickly to other countries and regions of the world. The transmission mechanisms through which contagion spread are many, including: "real contagion", in which investors believe that the shock to one country will affect other countries that are major trading partners and/or compete with it in the third markets; "financial contagion" in which multinational banks when exposed to increased risk in one market, are forced to reduce exposure in other regional economies; and "herd behavior" of investors, in which a crisis in one market leads to panic among financial institutions, who follow each other out of the market.

As economic integration continues its pace, what happens in one country does affect the others as well. This is what is meant by "policy externality"; macroeconomic policy in one country will increasingly have a bearing effect on macroeconomics in others. For Asia, we have become more interdependent. But the size of the affected countries was still small, whether looking from trade and finance, unlike the U.S. and Europe, representing more major global trading and financial players. Fortunately, with the help of the global economic environment at the time, this was a major supportive factor that had helped the Asian financial crisis a few years to calm down. With the abandon of the pegged exchange rate system that led to massive devaluation of our currencies, most Asian countries had been able to restore favorable trade surplus led by our competitive exports of goods and services. With that surplus, Asia has been able to rebuild again the accumulated foreign exchange reserve, accompanied with the IMF's support.

The severe financial crises have led to a rethinking of so many issues, but I would like to address here from an Asian perspective.

First, the global financial architecture has been deceptive at least as viewed from the Asian financial crisis. The IMF is expected to have a special role in crisis management with calls for its reform. But its performance has been disappointing. Most of proposals for financial reform both at the global and domestic level have not gone very far.

Crisis-hit countries are reluctant to pursue a more advanced approach to reform, given the impression they would like to maintain the status quo of the global financial system. Even with the leaders' meetings of G20, the reform of global financial architecture is slowly evolved and has not gone very far. As a result, domestic reform proposals have to focus first on improving bank regulation, supervision and appropriate macroeconomic policies. In Asia, most countries had gone through the process of reform. It was paid off as the market recovered and became more efficient. In the case of the U.S., the country's issue of “fiscal cliff” is now lying. For Europe, the issue of public debt and banking crisis is much more complicated as the countries in the euro zone can not devalue their currency causing them to adopt more austerity programs to address the crisis impact. The role of European Central Bank (ECB) is indeed crucial to work with governments, national central bankers, and those parties involved.

Second, the global financial crises have also reminded again to think about their own regional architecture building. Europe has put in place for sometimes its own regional financial architecture as well as the active role it plays at the global level. The U.S., as a global player, cannot treat in the same way as Asia and Europe. In comparison, finance has never been a central feature of Asia’s regional cooperation despite the success of development and interpretation in the real sector. After strongly hit by the crisis, a call for a regional financial cooperation through the Chiang Mai Initiatives (CMI) finally became a reality. Despite its imperfections, this cooperation has evolved into a CMIM, and is now again under study for an “Asian Monetary Fund”. There are many issues about the future of monetary regionalism in Asia but I would rather like to leave it for future debate.

Finally, these crises have been a soul searching for future economic development for so many countries. The U.S. and Europe are still struggling with their economies under the “new normal”. These difficulties will not go away easily, and will certainly make the world economy slow down at least for the next few years. An alternative is perhaps, the business sector worldwide to look closely on emerging economies, on how much they could provide them, replacing the western developed economies. It is also a fact that Asia had learned from these crises that their economies were not delinked from western developed countries, particularly for its final goods exports. If the region wishes to continue its path on a similar pattern of growth, it will certainly need to rebalance their economies elsewhere, and the best could certainly be in the region itself. Impetus for regional economic integration, whether it is ASEAN moving toward the ASEAN Economic Community (AEC) in 2015 or new initiatives for ASEAN + α Economic Partnerships, has the chance to grow under the presence of uncertain economic environment. If Asia would like to capitalize more on its future transformation, this is also a golden opportunity and timely moment to do so. Possessing comparative strength and resilience, the region might need to reassess the model of external demand dependency. It should possibly be more sustainable and inclusive economic development that would respond to the majority of the people and simultaneously contribute to the best of its ability, more environmentally friendly and harmless to the global community. Thank you for your attention.

Menon:
Thank you very much, Dr. Chirathivat. I think you really covered the whole range of interesting issues that I am sure will raise a lot of questions later on.

Our next speaker comes from the heart of the euro zone. Dr. Heribert Dieter is currently Senior Associate at German Institute for International and Security Affairs, and holds a post at the Center for Study of Globalization and Regionalization of the World Economy at the University of Warwick and also an Adjunct professor at the Free University of Berlin. He has also spent time all around the world including Asia and Australia and worked as a farmer for quite a few years. So he brings with him many skills to address these complex issues. Twenty minutes please.

Heribert Dieter *(Senior Fellow, German Institute for International and Security Affairs, Co-Director of the 2009 "Warwick Commission on International Financial Reform", Germany)***:**
Ladies and gentlemen, Excellency, thank you very much for giving me a chance to speak on a very hot topic, to speak on financial crisis in Europe. I think it is indeed a timely conference and I would like to thank the Konrad Adnauer Foundation, Mr. Jörg Wolff in particular, to invite me to this conference.

Heribert Dieter
- *We had an expectation that financial risks could disappear thanks to innovation. But we didn't know how it's gone.*

Key problem in this European crisis is of course the high level of uncertainty which we are confronted with. We don't know exactly what's around the corner. If you look at the situation of fiscal position, the figures wouldn't be all that worried. It has been mentioned in the introductory remarks by Ambassador Stanzel that the situation in the euro zone is not so bad as compared with the U.S. where the fiscal deficit this year is 8.4% , the UK where it is close to 8% and Japan where the fiscal deficit will be 9.9%. The fiscal deficit of entire euro zone of 3.0% this year is quite good. I think the Eurozone could join the euro zone if it were to apply today according to the criteria of Maastricht.

In my presentation I will look at four points. I will first look at the question how we got there and emphasize in particular the development in the U.S. and in Europe. Secondly, I will look at Greece. There is no doubt Greece is the most complicated of all cases in the euro zone. Thirdly, I will look at Spain, which is currently seen as a problematic case though I do not think Spain is so much problematic as many observers seem to think at the moment.

Lastly, as I come from Berlin, I will speak on what the situation in Berlin is like, what the mood in Berlin is like, what are the jams of policy makers, though we will hear more from member of the parliament Dr. Meister later on, and what the people on the street are thinking about the situation.

The first point; the crisis in Europe and in the U.S. It is 15 years ago when the IMF and the World Bank met in Hong Kong in the middle of the crisis and Mr. Sakakibara made his proposal for Asian Monetary Fund. That is when we had the Asian financial crisis and of course this could have been an opportunity for Americans and Europeans to learn from the mistakes of Asia. Unfortunately the crisis in Asia was wasted by the Europeans and Americans this time as mentioned before. The crisis in Asia was a little bit of schadenfreude for the Westerners. But it was our mistakes. We are subject to the turbulence. After 1998 we had made a very moderate effort to reregulate finance. We had talked about it, but we didn't do much either in international organizations or at national levels. Carmen Reinhart and Kenneth Rogoff have already mentioned about this in their wonderful book, "This time is different". They wrote in one section, "crises do not happen to us here and now. We are doing better, we are smarter, we have learned from the past mistakes, and the old rules of valuation no longer apply". That was the mood in Washington and Berlin and in other European capitals as well.

Ironically this was the similarity between the three crises. Underestimation of the risk had led the Asia to the crisis and underestimation of the risk has taken us into the crisis later on.

If you compare Europe and the U.S., government failure in Europe seems more important than the U.S. In the U.S., policy makers contributed to the crises because regulations were too weak. Key problem in the U.S. was that it was extremely difficult to identify who were the risk takers, who were the final destinations of the risk. We had an expectation that financial risks could disappear thanks to innovation. But we didn't know how it's gone. We had a chain of agents involved in the creation of asset backed securities but many of those agents in the chain had no interest in prudent banking or whatever. They had interest in volume but they did not have interest in prudent banking. Nor did the sellers of mortgages to the household, investment banks that created ABSs and the rating agencies that evaluated the products have any interest. So you had a chain of irresponsibility, rather than a chain of responsibility that contributed to the emergence of the subprime crisis in the U.S.

Queen Elizabeth II has famously asked why nobody saw the crisis coming, why nobody noticed it, why the entire world financial market was sleeping at the wheel. Well, I would argue that the market noticed. The market noticed that different products that were rated identically had different contents inside. In theory, if you have AAA rated products with the same maturity you should have an identical price. However, in the American subprime crisis, this was not the case. In case of asset backed securities you got a higher return for AAA-rated security than corporate bonds that were rated AAA. So the market detected those AAA rated products were not worth what the AAA label endorsed. I think this is an important thing to notice and you may raise a question, "Who bought those ABSs and CDSs?" There is a nice book by Michael Lewis's "The Big Short". Conversation between two traders is written in this book. One trader says, "Who buys that junk?" The answer of the other trader is "Dusseldorf, the Germans. The Germans believe in rating, and Germans believe in rules." This is probably also an explanation on what makes it so difficult in Europe at the moment.

Of course this buying of asset backed securities rated AAA by incompetent German banks wasn't all that smart. Landesbanks and other banks like IKB which has happened to be located in Dusseldorf were thinking that they could outsmart the Wall Street. They thought; Look! We get a 100 basis point higher than the identically rated products. So why don't we buy those products?

In hindsight we have to think again that this is the very important crisis management. And we have to answer the question in Europe. The question is, what was the mistake to let Lehman go? Should Lehman Brothers have been rescued?

There are two positions. One position is "Yes, this was a mistake of the century". The German weekly magazine, Spiegel, had this as a cover story and said this is a mistake of a century, Lehman Brothers should have been rescued and if it had been rescued the crash would not have happened or wouldn't have been so severe. The diverging position, as you know, is the crisis would have happened anyway. English has a very nice or funny expression that Lehman is only the straw that broke the camel's back. So the argument is that financial system was unstable. Other banks could have been the trigger instead of Lehman. I think this second position has a lot of contents. What has it resulted in? The collapse of the Lehman has re-injected some disciplines into the market. It has provided incentives to do prudent banking and I think it is the lesson that we should learn in Europe.

Similarities between Europe and the U.S. crisis were that they were fuelled by capital inflows. Ironically, the Asian financial crisis has been contributing to capital inflows into the U.S. The response of Asian countries was that they would never like to go back to the International Monetary Fund. In Korea you don't want to speak of the Asian crisis and you call it the IMF crisis anyway. So the attempts of Asian countries to build up foreign reserves require by definition that other countries are willing to accept current account deficits. So I think we can appropriately argue that without the Asian crisis the capital inflows to the U.S. would have been smaller. Perhaps the U.S. would have had the crisis but would have had to finance from their own bracket of non-saving. So the result would have been different and the damage would have been smaller.

And we have the same situation in Europe to some degree. Spain had a large current account deficit and Iceland had current account deficit of 25 % of GDP. Four out of ten households financed new vehicles with foreign currency loans. It is amazing. Ireland and Greece had large current account deficits. Those current account deficits associated with capital inflows financed unsustainable economic development for a long period of time. So this is the similarity that we have between the U.S. and the rest of the world, mainly Asia. As a footnote I would add that Italy's situation is of course different. They didn't have a large capital inflow but the country was badly governed by Prime Minster Berlusconi. Capital flows didn't play a major role in Italy. Italian state is poor, but its citizens are affluent. The net wealth position of Italians is better than that of Germans. Many people continue to assume that the affluent Germans are travelling across out shinny sea-sides and poor Italian relatives are welcoming them singing and celebrating. Maybe they are still singing and celebrating but they are no longer poor, which has repercussions on the European crisis management.

Next, I will briefly speak on Greece. Greece looks like a more failed state. It is a harsh situation which is deteriorating every day. The discussion is heating up. Currently the government wants to renegotiate a program that they are agreed with the troika. And this is difficult. In the IMF, there are emerging voices that urge the implementation of the program as it was agreed. They argue these can be special treat for Greece. And this makes the situation difficult. I do expect Greece will leave the euro zone sooner or later.

I think this is fair to say this is an ugly prospect but all alternatives are even uglier. The uglier alternatives are either the rest of Europe finances Greek's living standard for the time beings, which is difficult to say. Or Greek society is willing to endure another 8 to 10 years of structural adjustment which I can't see. The Greek society doesn't own this program and feels it has been dictated on them. It is very difficult to see that Greece will implement the program in the long term. So, again, I think Greece will probably leave the euro zone.

The third point is Spain. Spain is not seeking a fund without a proper program but is in a different category. Spain has very competitive transnational corporations. Spain has Santander, Zala, and it has a tourist industry to be able to compete. It had a real estate boom and bust later. But Spain is recovering. Just this week Spain announced it recorded a current account surplus in July, the first current account surplus ever since the euro was introduced. Spain is on a much better trajectory. It is not easy to start the program and I can understand the policy makers are reluctant to enter because it is quite easy to enter the program with Troika but very difficult to leave it. This is what worries the Spanish policymakers. They don't want to kneel because they feel it nearly stigmatize once they do it. The amount of money needed to recapitalize the Spanish banking sector is moderate €60 billion. That is not as big, considering that it is relatively a large economy. But it is painful at the moment because if the government does that, this adds to the government debts. So I think Spain will not recover before 2014, though they will in the near future.

Finally, I will mention the mood in Germany. I think it is fair to say that policy makers in Germany are in a difficult situation because its population doesn't support what they are doing. While 90% of the members of German Parliament voted in favor of rescue operations, 80% of the population was against it. We don't want to be liable for other people's profligacy. I don't think this is something unique in Germany. It's quite appropriate that German had reluctance to pay the bill for Greek or Italian profligacy. Some people think Germany is almighty at the moment. But I would just like to point out that we will not be able to enjoy a spell of sun shine forever. That wouldn't last forever. The German workforce is shrinking from 44.5 million in 2010 to 38 million in 2050. That's not so long down the road. So we will have to finance the debts of our own current generation with those 38 million workers in future. It will be more difficult and this is the part of the reasons why there is certain reluctance in Germany to provide checkbook diplomacy.

Last point: what does the people in the rest of the world or other Europeans think about Germans? The German bashing is very popular at the moment, and Angela Merkel faces many criticism starting from Paul Krugman or Martin Wolf of Financial Times. A poll published by the Handelsblatt shows that in Germany, 80% of the population is in favor of Angela Merkel and also 80% is in favor for the government. In France, 76% people think Angela Merkel does a good job but only 56% think their leader does a good job. In Czech Republic, such figures are 67% and 25%. In UK they are 66% and 51% .In Spain they are 63% and 45%. In Greek, they are just 14% and 32%. To sum up, I think what Edmund Phelps wrote in Financial Times in July was appropriate. It is quite correct that Germany asks for more austerity before any more union. Blaming Germany at this junction is easy but it's not very helpful.

Menon:
Thank you very much Dr. Dieter for the entertaining and insightful speech. I won't try to summarize all that you've said and instead leave the time for questions. Now, let me now turn to our discussant for the session, Professor Fan Gang.

Prof. Fan Gang is currently Director of National Institute of Economic Research, is also Chairman of China Reform Foundation (NERI-China), Professor of Economics, Peking University and the Graduate School of Chinese Academy of Social Sciences. He has a long association with many multinational organizations. Professor Fan, could I ask you to speak for about 5-7 minutes if you could.

Fan Gang *(Director, National Economic Research Institute, Secretary General, China Reform Foundation, China)***:**
Thank you to our organizers and audience. Our panel is about the retrospective of the history. I cannot help to think about the overall picture and the global picture. So I'd like to start with some of the global issues. It will be continued by developed countries issues and then return to issues of Asia and China.

I think we still need to have a lot of debate on what happened in the past. I'd like to recall the history since 1971, in which the Nixon shock delinked the dollar to the gold. That's the very historic moment. A lot of things have happened since then.

Fan Gang

- *basic point is that, in the case of developing countries, more prudence is needed.*

- *developing countries need to think more about risks than benefits upon financial development.*

We have heard that during 1980s and 90s there was overconfidence of the U.S. financial system. Since U.S. dollar became a standard currency, the U.S. had a privileged position. They printed money to pay their debts and there was no crisis in their international balance of payments, while other countries just made Americans more comfortable about their superiority of their financial system. The last straw of financial deregulation, the abolishment of the Glass - Steagall Act, happened in 1999. That means, deregulation and over aggressiveness had continued even after the Asian financial crisis.

For a long time, even European financial institutions were called old fashioned and over conservative. Then, some of the European institutions hired American CEOs and started aggressive innovation in financial products such as derivatives. I think that made America and the dollar the center of global financial market. What Americans were doing was really influential, including the financial globalization which spread overall financial liberalization to all the corners of the world. However, this led to the leveraging of subprime loans and all those things that ended up in financial crisis in 2008.

I think it is very important to consider the relationship between the crisis of private sector and public sector, when we think of global financial architecture and global crisis. European crisis is just a second stage of global financial crisis. During the private sector boom, refinancing and bond issuance were easier. This gave people the illusions that the market would follow such trend and the government would overspend its budget. Politicians actually overspent by giving more promise to the people to finance the public programs. However, rapid decline of tax revenue due to global financial crisis caused the public finance crisis of Europe.

Now, I will speak about Asia. The region suffered the overshooting of financial liberalization in the 1990s. Even now, many people say Asian countries' financial systems are weak and crony capitalism is the problem of their financial institutions. It has often been said that such problems should be solved by the liberalization of the country's financial market. But what happened actually was an excessive liberalization in some countries, causing new problems. There are technical issues on exchange rate and financial supervisions but the basic point is that, in the case of developing countries, more prudence is needed in opening the financial market. A small developing country can easily be attacked by hedge funds. Therefore, developing countries need to think more about risks than benefits upon financial development.

What is the difference between the aftermath of the Asian financial crisis and that of the global financial crisis? The former is a crisis of peripheral countries and the latter is a crisis of major countries, the U.S. and Europe. At the time of Asian financial crisis the global economy was still growing, financial bubble existed and developing countries were able to use them as an opportunity for recovery. On the contrary, global recession could last longer this time because any economy is strong enough for damaged economies to rely upon for their recovery.

Of course, Asian countries have learned a good lesson from the crisis. We are more prudent and put on more regulations. We know more about risk prevention and risk management mechanism such as regional financial cooperation. However, too much reserves built by Asian countries due to over-cautiousness is a big problem. It's a burden of providers of these reserve currencies, therefore needs to be rebalanced.

I will now speak on China. The country did experience crisis, a very typical credit crunch in the mid 90s. However, financial sector was basically closed back then, and because China was still growing by 6%, people didn't think the credit crunch was a crisis. Actually, non-performing loans had accounted for over 50% of total bank assets, and numerous restructuring took place, which took a long time to complete. China had three short periods of deflation during 1997 to 2003, and the mentioned crisis had occurred in the beginning of it. The crisis also caused public local government debt crisis.

Affected by the global crisis, Chinese government adopted a large stimulus package that allowed the local government to borrow. Their borrowing per year amounted to more than 15% of the GDP. Such a massive increase lasted only for a year, but it was a dangerous situation. China has been learning from all the domestic and foreign issues and is trying to adjust its policy making.

Finally, what conclusions can we draw from the lessons we've learned? I think the conclusion is simple. We need to be more prudent. We need to have a financial prudence. All the voices against more regulations and financial disciplines are typical, arguing that such measures will damage the efficiency and slow down the financial flow. But we know that all benefits are associated with risks and we need to balance them. That is the key message from history. Current situation is still devastating and we don't see it come out of the woods in the short run. I think the global financial sector will be improved after the current crisis is over. At the same time, I fear that, after some years, people might forget the lessons thus causing another crisis. I will stop here. Thank you.

Menon:

Thank you very much, Dr Fan Gang. I want to ask one question that relates to both of speakers in terms of the role of capital flows coming to the region. We know that in Asia the effect of external crisis this time affected more through the trade channel than financial channel. Banks in Asia were not so much heavily blazed in toxic assets. But solutions in the U.S., the so called QEII, produced a huge inflow of capital, which caused central banks' anxiety trying to keep their exchange rates from appreciating and further damping the trade flows. But now we observe in some countries quite a buildup of household debt. I'm just wondering how you see these. Is this something we should really be concerned as a secondary impact coming from the U.S., which seems to be creating the new wave of household debts? Also, in Thailand, Korea, and Malaysia etc the exchange rates are appreciating. I'd like to hear your quick comment.

Fan Gang:

I think the pressure of international capital flow is still a pressing issue. Capitals are looking for returns. And perhaps Asia is a safe haven compared to Europe at the moment. The capitals are coming to Asia's equity market, causing appreciation of our exchange rate. Since ASEAN countries are small in terms of financial market, they are appreciating quickly and central banks are looking for measures how to diminish those capital flows.

Dr. Dieter:

Yes, I think the issue you raised is of crucial importance: What would we do with this capital flow? Conventional thinking is that the capital flow is a good thing, and the liberalization of capital flow has been beneficial to the global economy. I think we shall spend more time to think about that preposition. Some people have done that like Barry Eichengreen, Kenneth Rogoff, Beatrice Weder di Mauro. Last week Brookings published a report by this very prominent commission of economists where they questioned the utility of unrestricted capital flows. The essential argue there is that we have a choice between two options. One is a full integration of capital market, the global capital market as Greenspan called them in 2005. This would require global rules, which are very difficult to create because we have diverging interest of countries that participate in this global financial market. If we can't obtain that, the alternative option will be the restriction of capital flows with national responsibility. What the commissioners argue is that currently we have the worst of having both, unrestricted capital flows and national responsibility. We see at the moment that the central banks providing the market with huge size of liquidity are potentially causing a new crisis. We know that there's a lot of water but we do not know where it will go to. We know some countries have already considered the situation very difficult for them. Just to mention Brazil which is confronted with capital inflows they do not want. They have put 4% tax on these capital flows, a very severe restriction. This happened as a kind of measure to somewhat moderate negative impact of capital flows but I think we should discuss this issue in greater details.

Fan Gang:

In case of China, capital inflows increased drastically in the current five years. In some years that outpaced the current account inflows. Mainly this is the inflow of FDI. There have been many acquisitions particularly during the past two years. Not a few of them are speculation on the property market and appreciation of RMB. So that kind of hot money is the major part of increase of the foreign reserves. How to deal with them is still a hot issue. The Chinese authorities have just tightened the control by more regulations.

Menon:

Thank you very much. If there is no pressing question, let me not summarize the discussion. All of you may agree that we had very stimulating presentations today from three speakers and the themes are well for the rest of the discussion today. Please join me in thanking our speakers for their presentation.

Session 2 - Sound Growth, Sound Finances, a Competitive Industry: Principles of the Social Market Economy in the Crisis Situation

Rajat Kathuria *(Director and Chief Executive, Indian Council for Research on International Economic Relations, India /Moderator)*:
Welcome everyone to the second session. This seems to be a very interesting session especially because we have all the ministers on the panel. Economists focus so much on their models and discuss what the models will yield and what the implications of the models will be like. But in sum those policies are going to be implemented by the ministers or the political process. And often in the developing economies, are diversions between what is economically good and what is politically expedient. I am very happy to have a discussion with the people who are actually doing the governance.

So thank you very much. The first speaker today, Michael Meister is going to speak on sound growth, sound finances, and a competitive industry. Obviously a complex topic, but he is quite equipped to deal them well.

Let me briefly introduce to you of Dr. Meister. He studied mathematics and informatics and holds his doctorate in natural sciences. He became a member of the Christian Democratic Union in 1991 and was first elected as a Member of Parliament in 1994. So he has a considerable amount of political experience. In 2000, he became a member of the Board of the CDU/CSU Parliamentary Group and served as chairman of its working group on financial issues from 2002-2004. Since then, he holds the position as the CDU/CSU Parliamentary Group's Deputy Chairman for budgetary, financial, and local policies and subsequently became a member of the CDU Federal Board in 2010. He's also been a member of the German Economic Council since 2007.

Mr. Michael Meister *(Member of Parliament, Deputy Chairman for Finances and Budget, CDU/CSU Parliamentary Group, Board Member of the Federal Council for Economics, Germany)*:
Thank you very much ladies and gentlemen and thank you Mr. Kathuria for the invitation. A series of crisis have kept the Western world in suspense for around four years now. What began as a crisis in the U.S. property market developed into a financial and economic crisis, then caused a sovereign debt crisis, which is now affecting our currency, Euro. This crisis is supposed to reflect the weak state of some of the Western nations and has actually curtailed the political leaders' ability to act. Irish, Portuguese and Greek governments resigned as a result of the crisis.

Michael Meister

- *we have to reorder the field and rethink the rules on the field --- and there you need a very, very strong referee.*

Before the crisis the political leaders in Europe were afraid to make reforms because it is very difficult for reforms to be accepted by the public. During the crisis we learned that it is also very difficult for politicians to make any reforms because there is a possibility they will not be reelected for leaving the work undone. It was not only these politicians that were not reelected, but if you look a little more closer you will see that big parties with long tradition in the Euro area have nearly disappeared. So, it is much more than a defeat in an election.

Commendably all of these countries are now undergoing to get their public finance in order. But even Switzerland, which is not a part of the euro zone, a nation characterized by confidence and stability, is watching the development of the euro with concerns because the appreciation of Swiss franc is having a negative impact on the country's economy. If you look at Swiss National Bank, they have start buying European bonds to stabilize the course of the Swiss francs against the euro. Now the Swiss National Bank is one of the biggest bond holders of German bonds. So even the country outside the euro zone is directly affected. And in the U. S. and Japan, public debts have grown to such crippling levels that have limited the ability of their government to take political actions.

The situation poses serious threat to the international financial order and it is the responsibility of policy makers to do what is necessary to overcome the crisis. The most important thing is to restore confidence in the financial markets and return these markets to their original purpose. Since efforts are not about propping up banks or maintaining the executive lifestyle, what is at stake is prosperity of society as a whole.

The past has shown the devastating impact that financial and economic crisis can have on jobs and personal savings, and this is something we must try to prevent. The financial and economic crisis has triggered a wave of regulations of the financial market. In addition to the numerous measures taken at G20 and European levels, Germany has imposed more stringent regulations on the financial market actors, expanded the rights of consumers and stepped up its monitoring of the financial market. Among them are, higher equity capital requirement, introduction of bank levy and insolvency regulation for financial institutions, regulations to limit executive remuneration, and stricter documentation requirement to protect investors. We still have several works to be done at this point.

I will make a comment to Mr. Fang Gang. I think the question of financial market is not about its liberalization, and the financial crisis is not a crisis of social market economy. I think the social market economy is the answer, but not the problem. The social market economy does not insist on overall liberalization, nor does it say everything should be regulated. We want to have a lot of competition to get effectiveness of the market, but on the other hand we want to have very clear and strict rules of the playing field. There will be lots of regulations and rules to follow. If the playing field is unclear, we have to reorder the field and rethink its rules. A very, very strong referee who will say "Stay on the field and keep the rules" will be needed.

Sovereign debt crisis has led to a rapid, serious development in Europe. For example, there was no bailout clause in the European Treaties. The beleaguered economies were bilaterally granted emergency assistance. Financial stability facility (EFSF) was approved and subsequently given more power. Euro area member states have concluded to start up the European Stability Mechanism (ESM). Various steps have been taken to improve the coordination of the economy and financial policy. These include the introduction of European Semester and its use on sovereign debt as a macroeconomic monitoring procedure. In addition, there is the Euro plus Pact. I think the discussion on the Euro plus Pact has not got enough resonance in the German public because it addresses the competitiveness of some euro members whose competitiveness are relatively low.

Employment is not solely created by competitiveness. It is also related to the welfare of the state. Improvement of financial sustainability reinforces its stability and coordinates tax policies. The struggle to combat the sovereign debt crisis in Europe is similar to the scheme used to take natural disasters: First, emergency aids were supplied at bilateral level. In the second step, emergency shelter was provided. That is the EFSE. Now we are building a permanent hospital, the European Stability Mechanism (ESM). The aim of all these measures is to preserve the stability of the euro. The goal is to bring the counties affected by the crisis back to the state in which they are able to finance themselves independently through capital market. We are buying time so that the beleaguered economies can restore order. Such support must lead to a reduction of sovereign debts, as the crisis cannot otherwise be overcome in the long term. This is the invariable principle.

We need time to solve these problems. National debts cannot be reduced in a few days. Of course it would be a relief for everyone if the solution were to be found quickly. But I don't see such solution on the horizon, particularly for Greece.

However, I want to make a remark at this point. We usually discuss currency policy, financial policy and economic policy. But if you look at European history, you should also look at things besides these. We had war for over thousand years. Integration is the answer to stay in peace and freedom, and the currency Euro is one part of the integration. It is not completed yet but we must. We can't give up the integration because it is a theme that goes beyond currency, finances and economy issues.

No one can say with certainty that this would not provoke further financial and economic crisis. That might come from Europe. The Lehman bankruptcy and the ensuing shockwaves on the international market that followed should serve as a lesson to teach us the importance of acting prematurely. We will do everything possible to keep Greece inside the euro zone. People in Greece will have to do their homework. We have to work on these simultaneously.

German GDP growth was minus 4.7% in 2009, the biggest minus since 1945. We are still working to repair the damage from the global financial crisis. If the crisis had not occurred, our federal budget would have been balanced by now. Instead we still have to borrow significant amount every year. But we are reducing the figures step by step and are trying to balance our budget by 2016 at the latest.

Germany labor market is strong; over 40 million people are employed and the number of long term unemployment has declined. 41 million was the highest figure of employed person since the end of WWⅡ. Less than 3 million people are currently out of work. The level of unemployment is comparatively low. People are benefitting from such development with significant wage and pension increase. Individual Germans are still happily spending their moneys, because they are not affected by the crisis. They have not lost their job. They hear in the everyday news and read in newspapers about the crisis but it's not their own issue. That's big problem for the politicians because we must take actions on things which the people do not understand thoroughly. We have our prudent citizens and companies in Germany. But there are also results of reforms of recent years, especially on the labor market as well as wage restraint. Nominal unit labor cost in Germany did not rise from 1998 to 2008. This resulted in a great improvement of competitiveness of Germany. Temporary stimulus packages we have agreed on during the crisis, particularly short-working system worked out well. These mean that Germany has done its homework. There is an image that Germany now sits back comfortably and waits for other euro area members to catch up and become more competitive, but this view fails to recognize that it is not a simple matter of competitiveness of individual countries in the Euro area. No country in Europe, including Germany, is able to withstand the intense competition against the U.S., South America or Asia by itself. Europe can only face such competition by working together.

Germany plays the major role in Europe. This is why further structural reforms are needed in Germany.

First, we need to deal with the transformation of energy system. We have taken a big decision after Fukushima. We decided to end nuclear power by 2020, and we have brought down 8 out of 19 nuclear power stations already. Renewable energy is scheduled to amount 18% of electricity by 2020 and 60% by 2050. These are huge change for the German economy and we have started big reforms already.

Secondly, I have to address the demographic change. In terms of pension policy, we need to rethink the retirement age which is to bring up from 65 to 67, the size of pensions and the role of private pension schemes. We need to reform nursing care and the health insurance system. We have to agree on a good immigration policy, which is courageous and will keep qualified people such as those who have graduated from one of our universities and willing to stay, by establishing straight forward procedures. We need to apply research findings without delay in order to protect well paid jobs. We must improve incentives to attract direct investments from abroad. We need to be more appealing as a location for investment, both in the divisional manufacturing sector and the service sector which has become increasingly important.

The social market economy provides basis for implementing such profound reforms and in turn for the reform's success of the German economy. It is what makes Germany different from the U.S. style financial capitalism and differ from the state capitalism of the former German Democratic Republic. The social market economy combines the principles of freedom based on the market principle with social compensation. It gives personal responsibility prior to the support provided by the state. It protects private property. It demands a balanced national budget. These elements lay the foundation for majorities to democratically support structural changes. Social market economy has also helped Germany to weather the current crises. Intervention from the so called automatic stabilizers and social security systems lessened the crisis's impact. Many people as I mentioned it before, did not even notice the crises at first. Social market economy is a successful mechanism for providing solutions and stability.

Nevertheless doubts have arisen on social market economy in the wake of financial and economic crisis. Some people are saying that the right balance between freedom and social compensation has been lost. I think it is not true. The federal government's recent poverty and wealth report showed that government assets have declined while the population's wealth increased. This is exactly what the social market economy promises to provide. "Prosperity for everyone" is a statement by Ludwig Erhard, one of the founders of social market economy.

Kathuria:
Thank you, Mr. Meister. I think that it is such a dawn for the discussion in the rest of the panel.

It's my privilege to invite Dr. Awang Adek bin Hussin to speak. He is going to speak on banking experience in the Malaysia Economy. Dr. Awek Adek Hussin is currently the Deputy Finance Minister of Malaysia. After the completion of his Bachelor's and Master's degrees in the U.S., and a Ph.D., he started his career as a lecturer in economics at Universiti Sains Malaysia. Subsequently, he held several higher positions at the Bank Nagara Malaysia until he was appointed Deputy Rural Development Minister in 2004. From 2006 to 2008, he served as Deputy Finance Minister and was called back to serve again in this position in 2009. He is eminently qualified to talk both about economics and politics in his state. Thank you very much Dr. Hussin.

Dr. Awang Adek bin Hussin *(Deputy Minister, Ministry of Finance, Malaysia)* :
It is my pleasure to be with you today. I would like to thank the organizers for inviting me to this important and timely gathering to discuss such an important yet elusive goal of securing sustainable growth and financial stability. While I don't have a crystal ball to predict what banking will look like in future, I believe that our efforts to refocus the financial system to one that is well grounded in the real economy would ensure a more lasting stability and sustainability.

The 2007-08 global financial crisis has left profound changes in the global economy and international financial landscape. The crisis followed a period of economic boom which saw the formation of a global financial bubble, fuelled by a speculative fever in the US housing market. Given the interlinkages of the global economy and globalisation of finance, what started as a crisis in the US subprime mortgage market has had a ripple effect throughout the world. The crisis has also exposed other weaknesses in the financial system, which exacerbated the effects across the globe.

The debate on the causes of the crisis continues to take place. In my view, rapid growth in finance played a major role in precipitating the crisis. A key development is how complex financial innovations, such as the widespread use of securitization and credit default swap, enable excessive leverage to take place. As a result, excessive leverage weakens the link between the financial system and real sector, which ultimately led to the disintegration of the whole financial system. Combined with weak supervision and regulation, and misplaced trust in the role of rating agencies, these risks grew unsustainable in size and scale across markets, domestically and globally.

Five years on from the onset of the crisis, the world economy continues to face grave threats to its wellbeing, weighed down by uncertain and fragile recovery in advanced economies, which are the epicenter of the global financial crisis. In the face of this challenging environment, we need to ensure that the right lessons are learnt from this crisis, so that the chances of similar catastrophes in the future can be prevented or at least minimized. Global debate surrounding important lessons from this crisis has sparked a fundamental rethinking of the roles of the financial system, the responsibilities of regulators and the objectives of financial innovation. In my view, an important outcome of this process, which also happens to be one of the most important lessons from the recent crisis, is the renewed understanding about the role of financial intermediation, and by extension, the functions that financial institutions are supposed to fulfill. Early economic literature argues compellingly on how the deepening and broadening of the financial system positively contributes to the economic growth. However, the rapid growth of financial sector in many advanced economies before the crisis, which far outpaced the growth of the real economy, undoubtedly, heightened the overall risks in the financial system and the economy.

Awang Adek bin Hussin - *Islamic finance has proven to be a potent tool for the nation to achieve a more inclusive, well-rounded and sustainable economic development.*

Clearly, there is a limit to what extent finance could positively contribute to growth. As learnt, highly leveraged financial activities that are not based on productive and real economic activities could pose significant risks to the sustainability of economic growth and development.

Consequently, there is now a broad agreement that banking needs to go back to basics – to provide services for the benefit of the real economy. I trust that we are here today because we all share this global resolve. And since excessive leverage as well as the delinking of financial intermediation from real economy can be a source of instability, it must be the case that future banking ought to be anchored closely to the real economy. This incidentally, represents the essence of Islamic finance – an alternative system of financial intermediation that is increasingly gaining global attention and appreciation – the subject of which I am going to share with you here.

Before elaborating on how Islamic finance would contribute to overall financial stability, allow me to share some thoughts on developments that are shaping economic and financial environment. I am sure neither of us here can confidently nor accurately tell how the global economy and financial system will look like far into the future, despite a vast literature of economic theories and sophisticated modeling techniques available today. The evolving crisis, which began within the world's major financial centres, is a solid proof as to how unpredictable the future can be. Despite not having a crystal bowl to look into the future, I can perhaps offer some outlook in the near to medium term, based on some of the prevailing trends that are currently shaping the global environment.

From a global economic perspective, Asia and the rest of the emerging economies have become an important source of growth and stability for the global economy. In 2011, emerging markets accounted for 63 percent of world trade, compared to 42 percent in 1990. Given the continued dynamism of these economies, we could expect that these emerging economies will continue to spearhead growth of the global economy. The International Monetary Fund (IMF) has recently forecasted that the total GDP of emerging markets could overtake that of developed economy as early as 2014. As these economies continue to expand, there have been plans for massive public and private investment activities to meet their long-term development needs, including in physical infrastructure telecommunications, education and healthcare. The Asian Development Bank, for example, estimates that Asia will require about US$ 8 trillion of infrastructure investment in this decade. There are clearly significant roles for the global financial system to meet these large financing needs of the real economy.

The evolution of Islamic finance as a new area of growth in the global financial landscape, particularly in Asia and the Middle East, is another important trend that is currently shaping the global economic and financial landscape in the recent decade. During the past decade, Islamic finance has grown from a niche market into a more global industry. Whilst the development of Islamic finance was initially concentrated in a few Muslim countries, it has now expanded its presence in the more established financial centers and other parts of the world. There are now 600 Islamic financial institutions operating in 75 countries. Growing at an average double-digit rate, the total Shariah (Islamic law) - compliant assets have surpassed the US$ 1 trillion mark globally

The development of 'sukuk' (Islamic bond) in particular has revolutionized Islamic finance in recent years. Sukuk, this high growth segment in Islamic finance, enjoys massive popularity for its competitiveness as an alternative fund raising and investment instruments for the global financial community. Broadly defined, sukuk is a certificate evidencing ownership of investors in a specified underlying real asset of the issuing company, along with the cash flows, as well as risks attached to the asset. Pure financial derivatives which are not backed by underlying real assets are prohibited under the Islamic law (Shariah). Therefore, unlike pure financial derivatives which causes irresponsible leverage as well as speculation, the strength of sukuk lies in its distinct structure which is tied to the funding or the production of real underlying assets, such as a parcel of land, residential or commercial buildings, machinery and equipment like aircrafts and ships, as well as goods or commodities.

This structure appeals to all investors as it discourages overexposure of the financing facility beyond the value of the underlying asset, given that the issuer cannot leverage in excess of the asset value. The structure of Malaysia's pioneering US$ 600 million global sovereign sukuk in 2002 for instance, was underpinned by a portfolio of prime real estate assets owned by the Government, whilst a selection of hospitals from a pool of 12 state-owned hospitals made the underlying assets of Malaysia's US$ 1.25 billion second global sovereign sukuk in June 2010.

Today, the sukuk market has become the preferred financing platform for both governments and the corporate sector as it allows issuers to tap from a wider investor base of both general bond investors and investors who seek Shariah (Islamic law) compliant funds, as evident by frequent oversubscription of sukuk issuances. The size of the global sukuk market has grown to US$ 210.8 billion as at the first quarter of 2012, representing a compound annual growth rate of 28.3%. In 2012 alone, we are able to witness a debut sukuk issuance in France and the rise in the number of sovereign sukuks issued from Middle East namely Qatar, Bahrain, Kingdom of Saudi Arabia and United Arab Emirates as well as emerging economies such as Kazakhstan and Senegal. In Malaysia, issuers are benefiting from the lower pricing of about 4 to 6 basis points in the sukuk market than mainstream bonds in the current environment. Meanwhile, the strong demand for sukuk, as opposed to its availability, has contributed to higher pricing in the sukuk secondary market, thereby generating good investment returns for investors. The Malaysian sukuk market has drawn the participation from a number of multilateral agencies, such as the World Bank and a sister institution of the World Bank Group, the International Finance Corporation (IFC), as well as the Islamic Development Bank, with several sukuk issuances to finance their development projects. A number of Japanese firms, such as Toyota Capital Services and Nomura Holdings Inc. have similarly issued sukuks out of Malaysia in recent years. Given its appeal to institutional investors seeking to diversify their portfolios, and to issuers looking to diversify their sources of capital to finance productive investment plans, such as large infrastructure projects, real estate development and corporate expansion, the outlook for sukuk is promising with tremendous scope for innovation and growth.

The rapid and sustained global expansion of Islamic finance in the recent decade, despite the global financial crisis, attests to its competitiveness as an alternative form of financial intermediation for the contemporary global economy. Beyond its competitiveness, the real impetus driving its rapid global growth lies in its unique inherent values drawn from the Shariah (Islamic law). It is important for me to reiterate that Islamic finance values have universal appeal. These values are to be shared with mainstream finance for mutual benefit of the entire global financial system. In our search for preserving financial stability and avoid the pitfalls of excessive growth in finance, we truly believe that we can learn from the experience of Islamic finance. Islamic finance promotes what is currently lacking and forbids what is damaging but currently allowed, in the international financial system. It offers the potential to achieve a vision of change towards preserving financial stability and promoting a more sustainable growth. Several fundamentals of Islamic finance support this elusive goal that we all seek.

First is the propensity of Islamic finance to align financial intermediation to its genuine role of generating business and productive economic activities, therefore reinforcing the positive relationship between financial flow and productivity. Islamic finance therefore operates a framework of financial intermediation that confines its activities to those which are supported by an underlying economic transaction, thereby avoiding speculative elements and excessive leverage. Through its emphasis for equity-based and risk sharing arrangements, Islamic finance emphasizes long term relationship between the financial institutions and their customers, focusing on the value creation and economic viability of productive efforts that create new wealth. It is, therefore, intrinsic in Islamic finance that financial expansion is invariably proportionate to the prospects of real growth in the economy, therefore ensuring sustainable progress and development.

Aspects of fairness, good governance and transparency are also strongly emphasized in Islamic finance, particularly in risk sharing arrangements. In particular, such contracts demand higher standards of disclosure and transparency to be observed, not only in the context of the documentation of contracts, but more broadly, as part of due diligence to ensure that the profits to be generated from productive efforts are commensurate with the risks being assumed.

Another key aspect of Islamic finance that promotes stability and sustainable development lies in the principle of 'moderation', which conversely, prohibits extremes or extravagance. This principle emphasizes a balanced approach, not only in finance, but in all aspects of people's lives. It is an important paradigm that is strongly encouraged in Islam in order to prevent people from inculcating greed and excessive love of wealth, some even to the extent of devouring other people's wealth for vanity.

All these fundamentals ingrained in Islamic finance, taken together, provide a framework of financial intermediation that is more conducive to both prosperity and stability. Through its ultimate aim, which is to spread socio-economic justice amongst humanity, Islamic financial principles bear relevance to the current crisis and to the much needed transformation in the post-crisis world.

Fortunately the Malaysian economy entered the global financial crisis from a position of relative strength. The Malaysian banking system was on a strong foundation with the strong level of capitalization (a risk-weighted capital ratio of 12.6% at end-2008) and low non-performing loan (net non-performing loan ratio: 2.2% at the end of 2008). The strong capitalization and ample liquidity in the banking system had ensured that the intermediation function remained uninterrupted, as reflected in the continued expansion of loans to businesses and households throughout 2008 and 2009. Total business loans outstanding expanded by 2.6% and loans to households expanded at 9.8% at the end of 2009.

As Malaysia is a highly open economy, the impact of the global recession was felt strongly in the external trade-related sectors. The recession in the advanced economies started to impact the Malaysian economy in the fourth quarter of 2008 and early part of 2009. However, the resilience of domestic demand, particularly private consumption, provided support to the economy. While the Malaysian economy contracted by 1.5% in 2009, the recession was mild and short-lived, with the economy rebounding with a strong growth of 7.2% in 2010. And despite continued difficult global environment, the economy grew by 5.1% in the first half of 2012. Positively, the growth in 2012 was supported by strong expansion in both private consumption and investment activities, following several transformative initiatives implemented by the Government through its Economic Transformation Program to raise the level of household incomes, create positive investment climate and improve Malaysia's competitiveness. The economy is expected to grow by 4.5 – 5.5% in 2013.

A key facilitator of growth has been the continued financial intermediation. The strong banking system and well-developed capital markets allow financing needs of businesses, individuals and the Government to be met effectively and efficiently. Our efforts to strengthen the financial system, through emphasis on strong corporate governance and risk management practices, as well as comprehensive regulatory and supervisory framework, are paying off. Loans to businesses and individuals grew by 13.5% and 12.9% respectively in 2011. While financial crisis and recession will continue to occur, an important aspect for public policy is to minimize the impact of the crisis on the vulnerable groups of the society including low-income households and small businesses. Recognizing this critical role of the Government, our policy responses to an economic slowdown are to always focus on preserving employment, ensuring continued access to finance by small and medium enterprises and enhancing social safety net for poor households.

Let me now turn to the development of Islamic finance in Malaysia. Malaysia has greatly benefited from the foresight to develop Islamic finance as part of our journey of nation building. Islamic finance in Malaysia is developed in parallel with the conventional financial system. The development of Islamic finance in Malaysia in complementing its conventional counterpart has served to significantly enhance the depth and diversity of the overall financial system, allowing the financial system as a whole to grow more effectively in servicing the broader economy. This in turn has enhanced the role of the financial sector to contribute more effectively to the economic development of the nation. Today, the Malaysian financial system has developed into a position of strength. Since 2001, the Malaysian financial sector has expanded at an average annual rate of 7.3%, to account for 11.7% of real GDP in 2010.

Indeed, Malaysia has taken a comprehensive, rather than a piecemeal development approach, culminating in the development of the entire chain of the Islamic financial system, comprising Islamic banking, takaful (Islamic insurance), Islamic money market and sukuk (Islamic bonds). This strategy has allowed for the synergy from the interdependence and inter-linkages between the segments to be drawn and harnessed, contributing to the emergence of Islamic finance as a dynamic component of the overall financial system. All segments of the Islamic financial sector have consistently recorded double digit growth over the last five years. At end 2011, total assets of the Islamic banking sector increased by 23.8% to 434.6 billion Malaysian ringgits to account for 22.4% of total assets of the whole banking system. The rapid industry growth has also contributed to the dynamism in employment trends. Employment in the Islamic banking sector has grown about seven times faster than conventional in the last decade. The Malaysian sukuk market has evolved to be the world's largest Islamic bond market, with a market share of 60% or US$ 108 billion in outstanding sukuk as at end-2011. We are also seeing steady increase in the issuance of foreign currency denominated sukuk in Malaysia, accounting for 14.5% of US dollar denominated sukuk issued globally. The dynamism of sukuk has been pivotal in contributing to the development of a vibrant bond market in Malaysia, expanding at a rate of 22.2% per annum between 2000-2010, spurred by a continuous stream of product innovation during the period. In 2011, the Malaysian bond market has grown to 105 percent of GDP, out of which more than 40% of the outstanding bonds are Shariah (Islamic law) - compliant.

Islamic finance has proven to be a potent tool for the nation to achieve a more inclusive, well-rounded and sustainable economic development. Whilst it began as a strategy for greater financial inclusion in reaching out to the underserved segment of the Muslims, Islamic finance has progressed into a competitive form of financial intermediation for retail customers, businesses as well as the Government, and in the more recent decade, spreading its reach to serve the global community. At a time when world economy is slowing down, Islamic finance is, more than ever, central to our agenda for sustainable growth and development. Building on our strengths and expertise, the Islamic financial services sector today is well-positioned to be a key sector of strategic growth to facilitate the economic transformation of the nation to be as a high-income economy. Moving forward, Malaysia will be consolidating and capitalizing on the country's comparative edge in Islamic finance to intensify financial integration and connectivity with international economies, particularly to support expansion of trade and investment activities. This forms part of the strategies to further reinforce Malaysia's position as a leading international Islamic financial centre.

I believe that the recent crisis represents an important opportunity for all of us to make a meaningful change. To emerge from this crisis with lasting, equitable and inclusive social and economic progress that is built on a sustainable growth with financial stability, a key strategic agenda for banking in the present, and the future, must continue to rest on ensuring an effective framework of financial intermediation that serves the interest of the real economy. Malaysia's unrelenting pursuit in Islamic finance represents our commitment towards this noble aspiration. It is also a shift from excesses in banking and finance towards more moderate, responsible and sustainable economic order globally. On that note, thank you very much.

Kathuria:
Thank you Dr. Hussin. The underline you put is similar to Mr. Meister's theme. Unregulated and unfettered market will not often serve the purpose.

Let me invite the next speaker, Mr. Takehiko Nakao, who is the Vice Minister of Finance for International Affairs at the Ministry of Finance in Japan. Mr. Nakao also holds an MBA from the University of California at Berkeley, and graduated from Tokyo University in 1978 (BA Economics). His experience has been with the Ministry of Finance and has served in a variety of bureaus such as Tax, Securities, Budget, International Finance, before taking his present post in 2011. He had been in Washington as a Minister at the Embassy of Japan from 2005 to 2007. He has a ringside view to talk about Japan's Role to Ensure Stable Financial Markets and Economic Growth in Asia and the World in the International Crisis.

Takehiko Nakao *(Vice Minister for International Affairs, Ministry of Finance, Japan)* :
Thank you very much for a kind introduction. Two previous speakers spoke of specific issues on Germany and Islamic finances, so I would like to speak more broadly about the lessons learned from the crisis. I would touch upon the lessons for social and economic governance. It is a really good timing to have this kind of a meeting, because we will have Tokyo Annual Meetings of IMF and World Bank next week and the crisis is not over at all especially regarding the euro sovereign crisis.

Takehiko Nakao

- *We should be careful to reintroduce appropriate regulations without harming needed activities.*

- *From this crisis it becomes even more obvious that sovereign state's government can provide more important underpinning to the market economy.*

First, regarding the lessons from this crisis, obviously one lesson is that, bubble and its burst, can occur in any economy. When we had a crisis in Asia in the late 1990s, many people, especially Western economists, associated the Asian crisis with the nepotism or a cronyism type of capitalism with very weak governance of banking sector and inappropriate macroeconomic policies. But the same kind of crisis happened in the U.S. and also European countries which were regarded as very reliable economies with strong governance. So crisis can happen anywhere and the reason is, as many speakers have already mentioned, we have a flow of capitals liberalized to the full extent.

Before the crisis there was an idea that the free flow of capital and fully liberalized financial market are best ways to achieve higher growth, and the risks can be well managed by the private sector. It was thought that there is a very small role for the government to play whether on regulations or policy related lending by JBIC or JDB. After the crisis, we found these naive or simplistic ideas were not all correct. One important lesson is that macroeconomic policies should always be more prudent even if the consumer price index is stable. We must pay more attention to the asset prices and the market's instability and excessiveness. Such things can be measured by the financial assets to GDP ratio, for example. The ratio has increased since the first usage of money in ancient times. However, its sudden jump will pose some risk to the economy. It should be in proportion to the growth of the real sector economy. As I said before, the ratio can increase over years but its increasing pace should be stable. So the macroeconomic policy, especially monetary policy should pay attention to the stability of the financial system and assets prices, in addition to the prices of goods and services. Before the crisis there was a view in the U.S. that bubbles are unpreventable because it is difficult to tell whether the situation is a bubble or not. Additionally, it was thought that once the bubble burst, the FRB can quickly intervene in the market by providing ample liquidity and prevent crisis, which we later found out to be difficult. After the Lehman crisis, though monetary authorities provided liquidity amply in a decisive manner, naming it the 'unconventional policy', they could not stop the financial turmoil as expected in the past. The so-called Greenspan Put did not work as expected. This is one lesson.

Second, another lesson is, as many people have already mentioned, that we should pay more attention to the financial regulations. Of course, financial activity is the basis of growth for countries and industries. Without the truly appropriate activities of the financial sector, the growth in these countries or sectors could be lower. But at the same time we need to have prudent regulations to financial activities.

Market can solve many issues and manage risks appropriately, but not always. People make mistakes. Herd behavior occurs, which means people tend to join others without looking at risk for themselves. Risks can also become higher when there is a possibility for financial institutions to be saved by the state's guarantee of deposit and liability, or in the end, by tax payers' money. This causes a serious moral hazard. Therefore, though public bail-out of financial sectors helps short-term stability of financial markets, that may cause a stronger motivation for the managers of financial institutions to take higher risks with larger leverage. Market can work properly for the wealth of national economy if there is information symmetry, if there is no moral hazard. But if we allow asymmetry of information and misguided incentive structure of financial sector to exist in financial markets, that will cause problems. Also, since financial sector is a public good, they will be taken care by the state in case of crisis to prevent households and corporate from losing basic economic infrastructure such as deposit or money transfer etc. Therefore we need proper regulation on the financial sector.

This does not mean we need to adopt stricter financial regulations by choking the incentives of financial sector. In my view, we cannot return to fixed exchange rate nor to heavily regulated financial industry with interest rates restriction. Many people ask me a question why we can't return to the fixed exchange regime that is more stable and there is no need to worry about floating exchange rate which causes huge trouble to the private sector. Corporate of private sector are striving to save even one percent of their cost. Changes in exchange rate, for instance, 5 percent a day, gives a disastrous impact on them. What I respond to the question is: Of course it is desirable to have a stable exchange rate, but we cannot go back to the fixed exchange regime due to increased capital flows and financial deregulations. Increased capital flows across borders have a merit for efficient resource allocation, hence promoting higher growth of economies. Also, though we try to introduce capital controls and financial regulations, there are measures to avoid it.

We should live with this new system of free flow of capital and innovative but prudent financial activities. We should be careful to reintroduce appropriate regulations without harming needed activities. For instance, we have asked the US authorities to pay more attention to the problem caused by extra-territorial applications of certain financial regulations which come from Dodd-and-Frank Law. The US regulators ask foreign banks to register themselves as a swap dealer, which is truly an extra-territorial application of the law. Their intention to prevent the excessive transactions of swaps should have a mismatched effect. Those are lessons we have learned. There are no 100 % clear-cut answers. We need a balanced regulations and macro-economic policies.

Third, another related point I want to mention is the importance of functions of sovereign state. The sovereign state is basically needed to take care of public goods and regulations and so on. But from this crisis, it became even more obvious that sovereign state's government has very, very important role more than expected by many observers to underpin market economy. When crisis occurs, governments need to inject capitals to banks, guarantee deposits and other liabilities of banks. Sometimes we need to guarantee them with no limit in order to avoid bank run. Of course we must worry about moral hazard, but at the peak of a crisis what we should worry is a total collapse of financial system which is more socially and economically costly than worrying about moral hazard.

In late 1990s, many Western economists, especially American economists, continuously urged us to let our banks go bankrupt if they are not sustainable. The U.S., however, chose to avoid the collapse of financial institutions as much as possible except for the case of Lehman Brothers, because the collapse of financial institution is very costly in both economic and social term. I am not against this US policy decision. Sovereign states need to do it.

In addition, sovereign states must provide a certain stimulus to sustain the economy and to protect employment when the economy is greatly shocked. If the employment is unprotected, it will lead to a damage to human capital, which could have a long term impact on the potential growth of the economy. That is why intervention in the market in the time of difficulty is essential. Sufficient support to the weaker section of the society, including poor and sick people, unemployment insurance and social welfare to the poor should also be offered in the wake of crisis.

The importance of these functions became more obvious after the crisis. One reason is because the turmoil of euro zone remains as it is. Though there have been many efforts made by the euro zone countries, tackling the issue with decisiveness is difficult because it is not a single sovereign state, and the taxpayers are divided in 17 countries. I think challenges of the euro are very difficult although I believe the euro zone countries will aim to unite the forces to address the structural issues of a single monetary union.

The states have many functions but there are many constraints or limits in what they can do. When large money is spent for saving the failing institutions or stimulating the economy, it tends to cause deficits and debt overhang. Japan now has 240 % of gross debts to GDP and yearly deficit of 10 % to GDP. Over regulation sometimes causes choking of the private sector, and intervention by the government causes moral hazard. If we support the poor people by giving cash without checking their capacity, it might cause a moral hazard.

I visited Beijing recently and met a senior economist aged over 60, who gave an interesting comment. When I asked him whether China is ready to provide additional stimulus package like they did after the Lehman crisis, he was more prudent than I imagined. He said we should sometimes allow economic cycles to head to the end, not resisting its huge movement. He also mentioned that an economic downturn can be the opportunity to make enterprises and the state to streamline their way of doing things, and that continuous support to combat the economic downturn can delay the necessary reform of both corporate sector and state sector. These are constraints for the state, but as I said, it is obvious that we need to look at the functions of the state and the balance between private and government sector.

I do not have much time left but I would like to mention one thing. It is about Japanization. It is a word for several things that Japan has faced in the past 20 years: low growth, fiscal problem and zero-lower-bound constraint of monetary policy. These difficulties all make decisive political decision difficult. In an interview by the BBC radio program which I did when I visited London in August, I was questioned on why Japan was able to maintain social integrity and low unemployment amid difficult periods. It was an interesting question because the Japanese unemployment rate remained around 6 % even at its peak and now it is around 4.3 %. Unemployment was kept at a reasonable level. Maybe it owes to the fiscal policies to stimulate the economy and also to the companies effort to avoid firing employees as much as possible. That is a Japanese style of social market economy. It is not by law but by customs. However at the same time, because of those policies, industry reform or its transformation from less productive area to new areas could have been slower and also may have led to the huge debt of the government.

So there are pros and cons. In the case of Japan, social and economic governance so far has been OK. If you look at the town of Tokyo, it is such a stable and pleasant place to visit that we cannot see, at least superficially, dire problems. But the question is whether such an environment can be sustained or not. Unless we transform our economy to a more productive and more opened one, we will face slower growth at a time of aging and at a time of fiscal difficulty. That is really challenging. I cannot provide any specific solution, but Japan is now facing new challenge: to find a solution to sustain the level of living standard and social integrity. This is what I spoke in the BBC interview and what was actually broadcasted as my British friend later informed me. Thank you very much.

Kathuria:

Thank you, Mr. Nakao. You've brought up several important issues on the financial market and other sectors. The market fails, if not most all the time, due to moral hazard, asymmetrical information, or whatever reason. It is the reality of the economy. Managing economy is a challenging task for a government even at the best of times.

I think the conflict between politics and economics will continue. There will still be 15 minutes left so if there are some pressing questions you have, three eminent persons from different countries will take some of them.

Omura *(Oshima shipbuilding company, Audience)***:**

My question is to Mr. Meister. From the previous session I understand that German citizens do not agree on supporting the Southern European countries which have been lacking discipline. But the world has a great concern about the euro zone economy. So my question is, in your view, can the euro zone economy overcome the crisis without further extension of German support to the Southern European countries or is there a risk for euro zone economy to collapse?

Meister:

First, 70% people in Germany like the idea of Europe. So the basic idea of keeping European integration has a very high support there. On the other hand, same number of people should say no to guarantee other European countries. I think in the long term the solution can be Germany's financing other states. But income transfer cannot be the fundamental solution of the problem. During the last two years we have successfully implemented many integration steps such as the European Stabilization Mechanism. I think these receive a big support from German people.

Second point is the competitiveness of the various economies. Germans have learned in the last 15 years that we have done numerous reforms to strengthen our competitiveness. Now the German people are asking the neighbors to do so.

Komiya *(Mitsubishi corporation, Audience)***:**
I would like to ask Mr. Nakao. Many newspapers report that there is a debate between the Central Bank of Japan and parliament members on setting an inflation target at 2% or so. The FED sets maximum employment, stabile prices and moderate long term interest rates as their goal of monetary policy, but BOJ's purpose is plainly price stability. Some people blame this for the continuing deflation. What is your view on that?

Nakao:
First of all I should not mention too much about the BOJ and its policy because it is an independent authority, but to be frank the government has asked the BOJ to take more decisive and proactive policies. I have a very strong belief that in today's advanced economies the deflation is more imminent risk to the economy than inflation. Of course the central bankers might have different views. But at a time when the power of labor unions is weak, fiscal policies have become more reasonable and there exists more competition from abroad causing fewer bottlenecks when the economy is growing, deflation becomes a greater risk for developed countries. Once caught into the deflationary spiral, it is very difficult to escape from it. In that regard the monetary policy can be more decisive. But at the same time it is true that the BOJ has tried so many things in a very innovative way; quantitative easing which was introduced much ahead of FRB and ECB, unconventional measures by purchasing various assets including stocks and REIT. They also made a commitment of zero percent to the future, a scheme developed by themselves. BOJ's asset to the GDP was much larger than those of ECB or FRB before the crisis and as large as them today. In that regard, I'm not so sure about the best way to handle this issue. Of course we must worry about deflation because it is really impeding the growth and the motivation of the people, but at the same time, how we can deal with this issue most appropriately is a more difficult question. If we can achieve inflation by settling the inflation target, it is ok. Once again, it is up to the idea of the BOJ.

(**Session 2: Afternoon Discussion)**

Kathuria:

Welcome back everybody. May I request Nicholas Fang to make his remark? Briefly, Nicholas is the director of the Singapore Institute of International Affairs. He has graduated from Oxford University with a Master in Politics, Philosophy and Economics, and worked as a journalist at The Straits Times for nine years. So he has seen both sides of an economist and politician. He then took a new position of business editor and presenter at Singapore's National Broadcaster Channel News Asia. He was appointed as a Nominated Member of Parliament of Singapore in February, 2012. Mr. Fang concurrently holds positions as director of a private defense material agency and a sports consultancy firm. Mr. Fang, please.

Nicholas Fang *(Director, Singapore Institute of International Affairs, Singapore)*:

Thank you very much once again to the very kind organizers for the invitation. I would like to focus a little on the lessons we can learn from the crisis. I think one of the key facts to bear in mind is the ASEAN's aim to integrate into what is called Asian Economic Community by 2015.

Nicholas Fang

- *financial integration doesn't automatically translate into efficient allocation of capital.*

- *ASEAN countries need to construct policies that provide better wages as well as basic welfare and healthcare services.*

This has been in the works for few years. Its aims are to have a common market, production base and free of movement of skilled labor, very similar to the goals that were set out in the formation of the euro zone.

One thing Asian can learn from the difficulties the euro zone is facing is that the cause of the problem in the regional integration is not what recently occurred but what they had from the start. They are the lack of flexibility in monetary and fiscal policy for euro zone countries, due to the single currency and its "one size fit all" approach. There were no region wide financial safety net and oversight, no fiscal transfer mechanism, no enforcement to deal the fiscal imbalances between the countries. Such problems were overlooked in favor of European unity.

Prices and wages increased more quickly in the periphery countries such as Ireland. Between those and core countries like Germany, we now see a vast macroeconomic imbalance. Asians do not face same problems with euro zone because, first of all, we are not going to be bounded by a single currency. And the degree of integration within the Asian Economic Community will not become the same as what we see in Europe.

However, we do have some similar challenges. One is the vast disparity between member economies. Indonesia, Singapore, Thailand, Malaysia, Philippines and Brunei are very different from smaller economies like Cambodia, Laos, Vietnam and Myanmar. Therefore Asia must seek its way to achieve the benefits of greater economic integration without running the risk of very tight integration like that of Europe, where internal shocks are easily transmitted between countries.

Asian may need more institutional frameworks to control those risks. I think we also need to keep in mind that ASEAN and other Asian countries should not be too hasty in adopting monetary and exchange rate integration schemes which could result in crisis. We should consider a more gradual and flexible approach, for instance managed floating regimes with currency baskets. It is now clear that international financial integration doesn't automatically translate into efficient allocation of capital. ASEAN and their regional countries are headed to freer flow of capital as a part of new economic community in 2015, but we definitely have to be cautious in determining what kinds of capital flows are favorable for its development and which money would be detrimental. Countries like Myanmar which have opened its economy, for example, are currently very concerned about the investment towards them, which many investors are very keen to begin.

At the same time the region's countries are already forming their own arrangements in response to potential crisis rather than simply relying on global institutions like IMF. We have the ASEAN plus 3 Initiative, which is a regional crisis prevention and resolution mechanism in the form of the Chiang Mai Initiative Multilateralism (CMIM). There is a formal binding currency swap arrangement among ASEAN plus 3 to provide liquidity support to any ASEAN plus 3 countries in the event of liquidity crisis. I think it a good sign of steps taken by ASEAN plus 3 nations to secure their economies.

This May, China, Japan and Korea signed a trilateral investment agreement. Current island disputes have played a significant role in diverting attention and politicians might be away from such talks. However, if the resolution can be achieved in the next few months, we could see a resumption of focus on FTA issues.

Aside from ASEAN's plan to integrate into the Asian economic community, the countries have also launched formal talks targeted for next year to create regional comprehensive economic partnership (RCEP) which is a free trade agreement to bring together existing FTA partners with ASEAN. These countries include Australia, China, Japan, Korea, India and New Zealand. It is basically planned to unify trade agreements to create a single free trade area that targets to remove 95% of tariffs on goods. This free trade area could potentially comprise some 3.3billion people. At the same time China and Hong Kong are planning the inclusion of Hong Kong in the existing ASEAN-China FTA.

I think it's worth noting that many of these regional initiatives such as Chiang Mai Initiative or CEP are based around ASEAN, which is different from euro group. One of the key characteristics of ASEAN is its neutrality. It is a collection of small and medium size countries, not a superpower. Some countries might not be willing to participate in initiatives that are started by a potential competitor. But ASEAN is an acceptable neutral driver which has some advantages in terms of pushing its own agenda forward. ASEAN also holds regional summits. The ASEAN Regional Forum, one of the few multilateral meetings where North Korea attends, is becoming more and more important for regional governance.

Studies have suggested that the actual utilization of ASEAN FTA (AFTA) is far lower compared to utilization of FTAs in other regions such as NAFTA, possibly because of transaction cost. Some people have said that ASEAN is mainly working in economic sphere rather than purely political sphere. ASEAN minister meeting in Phnom Penh has shown a failure in issuing a statement on the South China Sea. ASEAN unity and utility cannot be taken for granted.

I would like to speak lastly on the social government challenges faced by countries in Asia, specifically ASEAN. Widening income gaps between the region or the country causes economic, social and also political concern given that the have-nots in Asia become increasingly vocal. Economic disparities in Asia are much more stark than those of the developed world. ADB outlook 2012 inscribed that Asia's GINI coefficient has increased from 39 to 46 during early 1990s to late 2000s. This degree is still lower than many developing countries, but widening disparities is definitely a cause for concern in Latin America. In Singapore, which is a good case study of a successful small nation, the income equality gap coupled with stagnation of social mobility is becoming a serious problem and general sense of citizen's well being is decreasing.

We haven't really seen in Asia the type of protest movement like the Arab Spring or occupy movement in the U.S., but I think they are something that needs to be looked at. We have seen unrests in part of China in recent years. Malaysia, Thailand, Indonesia, even the Philippines have seen domestic protests. In Singapore, for example, the ruling government decided to slash ministerial salaries in response to growing concern and wide spread sentiment that ministers are overpaid.

To sum up, I think ASEAN countries need to construct policies that provide better wages as well as basic welfare and healthcare services and which would act as safety net as well as spring board for social protection. This is one of the issues we are going to actually learn from our counterparts in Europe. Wages will rise in the light of Asia's regional development, but skills and productivity of the workplace must also increase to keep a pace of economic growth of ASEAN continues. Thank you.

Kathuria:

Thank you, Mr. Fang, for those insightful remarks. We will come back to questions after the second discussant.

Let me briefly introduce to you Mr. Ronald Mendoza You have Mr. Mendoza's profile in your pocket Ron Mendoza is currently Associate Professor of Economics the Asian Institute of Management as well as Executive Director of AIM Policy Center. Prior to his appointment at AIM, he was a senior economist with UNICEF's Policy and Practice Group in New York. In addition, his research background includes work with the UN Development Programme's Office of Development Studies, the Federal Reserve Bank of Boston, the Economist Intelligence Unit (EIU), and several non-governmental organizations in Manila. Thank you, Mendoza.

Ronald U. Mendoza *(Executive Director, Asian Institute of Management Policy Center, Philippines)* :

Thank you for the kind introduction and thank you to the organizers for inviting me to share some thoughts with you today.

Ronald U. Mendoza - *the challenge for my country right now is that a child that is born today needs to get a good and strong foundation in order to be a contributing citizen and tax payer in 25 years from now.*

Many people think that they are suffering by paying the price for the crisis they had no part in creating. When I was in the UN, we did research on the impact of food price shock in 2008, global financial crisis in 2009 and global economic slow-down that began in 2010. One of our advocacies is that the budgets were being basically contracted in many countries including those that were marginally affected by the crises. At the beginning, many developing countries were actually in denial. They were thinking that this crisis that began in the Wall Street will not reach them. But since we are all connected in this modern economy, all the countries were impacted through different channels, as the crisis moved on.

The general context that we are working on at this symposium is not just an economic context. Almost every speaker says that their countries are now looking for their future, rethinking their growth model. I found this very striking because in the Philippines we are doing this as well. We are trying to see why we didn't participate in the boom that happened to the other East Asian economies and whether it is because our economic governance was appropriate.

First presentation by Mr. Meister mentioned that one of the many things Germans did in terms of mitigating the social impact of this crisis was having a mechanism to discuss how they would go about in addressing the crisis. Therefore there was very little uncertainty towards the role of the labor unions, the private corporate sector and the government. They had existing mechanism or existing cultures of consultation that allowed them to facilitate their own brand of crisis mitigation. I was struck by this.

I was once explained by our colleague in Konrad Adenauer in Manila on how the three groups, labor unions, private corporate sector and government got together and agreed not to let massive lay-offs occur and also to have government support in order to avoid the adjustment to be so stinging. This worked out well. When the economy was rebounding, the workers were ready to actually take place in the recovering process as they were not gone from work for six months or eight months. This kind of adjustment mechanism is missing in many other economies. What they have done was an introduction of element of uncertainty. The lack of understanding between private sector and the labor unions adds on to the corridor of crisis itself. I found this lesson from German experience to be very interesting and also thought that other countries should manage to do this as well.

The second presentation by Dr. Hussin pointed out Malaysia's effort to make their financial sector much more inclusive. This struck me because it means they have been developing a market on their own. Essentially this is partly what Islamic finance is about. It basically addresses a group that formal financial system never has. It is also trying to integrate such group into the international financial system. Malaysia had innovated and built this particular market including the institutions for credibility, the mechanisms for trading, and the actual instruments.

One of the biggest issues of the set of crises is that people who did not take part in the boom period, who did not enjoy the euphoria are actually ending up paying the costs of crisis. In this sense I think we can learn a little bit more from Malaysian experience that in the good times you can start to think of the role of the public sector, making the boom a little more inclusive. The people in the Philippines do not enjoy the benefits of financial integration as other nations do. Yet when the crises occur, they end up paying for it through taxes because we socialize the bailout. Even if there is no bailout they still end up paying for it by losing their jobs or by payment cuts. How we can promote more inclusive growth process is perhaps something we need to spend some time on.

Third presentation by Mr. Nakao had pointed out the challenges and also the opportunities of the sovereign state. I think there are many economists in the room that are familiar of how the power of sovereign state has been eluded by our financial and economic integrations. This may be true, but we can recoup some of the power, some of the impetus for promoting more effective change. This can be done through reforms which can particularly be done during the crisis periods --- the reforms that one cannot think of implementing during a period of boom or a period of stability.

Now we can start to rethink more deeply over the kinds of reforms we can pursue. Perhaps this period of crisis is not just a bad period which we should hasten to leave but also a good period for us to think about how we really want to structure economies and societies. We shall begin to be more deeply integrated and figure out the chunks of our population which may not have been included in the earlier growth process.

So what struck me was that many countries are resorted to boosting their social protection systems. Crisis are no longer aberrations, they are reality. With some predictability the world faces with crises. There is a commodity crisis in Africa every five years and financial crisis of some magnitude in emerging economy markets every seven to ten years. If we know it will happen, we'd better get prepared.

Not just in Asia but many countries of the world have started to think more deeply about social and economic governance. Some countries have more focused view on the arrangement of a safety net. It allows no one to fall below a particular level of the standard of living. Some societies have implemented the programs and have actually achieved them. On the other hand some societies are much more ambitious. They don't build the safety net, but build ladders so that people can move up in the society. I think this is more interesting and promising at least for Asian societies. Social protection systems for most of emerging countries in Asia only started when they had a rude reality of the food price shocks and the global financial crisis.

I think these types of reforms are essential in order to build more robust future for the entire region and this is where the sovereign state really has a key role. Again many countries in Europe and industrialized world have strong histories of building such schemes. In countries like India, for instance, having a job is a basic right and the state guarantees it. The state has basically guaranteed a few month of insured work as far as I understand. This is the national rural employment guarantee scheme of India. If you want to work they will provide this work. Of course there are many challenges in the implementation of this program that will make many economists cringe as far as governance and efficiency challenges. But they have decided as a society that this is how they want to go. Anyone who wants to work can get from the government a guaranteed work. I think those are the type of things that are happening right now and many of them are motivated by the sense of building the safety net and also the ladders.

Now, I will start to wrap up. The sovereign state can only go so far as its budget allows. This is the other reality that we need to deal with. Mr. Nakao basically emphasized the things we can do as countries within our societies. There are many other things that the states cannot do. I'll just cite aging societies for instance. 25 years later, the Philippine will not have as many young people as we have today. A child born today needs to get a good and strong foundation in order to be a contributing citizen and tax payer in 25 years from now. However if the child does not go to school, does not get nutrition and live in a shock-prone or climate-prone country, then the child will become a man or woman who are incapable to have a strong contribution to our economy. That is my country's particular challenge.

I would argue that this is an opportunity for other aging countries and for those that wish to relocate their investments in places with potential of high productivity gains. Countries with young population are able to contribute to such movement as well. Let me leave it here and I look forward to a good exchange.

Kathuria:
Thank you Ronald especially for making my job easy. He not only made his remarks but also summarized what the speakers had to say. Instead of wasting time by repeating what Ronald has said, we can open the floor for discussion. Yes, Javant.

Menon:
I have a general question about regionalism and its future. Particularly, on those of Asia, which are learning from the crisis of Europe. After the Asian financial crisis we had a resurgence of interest in regionalism. It seems to me that European crisis was a result of interest in regionalism, or a result that her regionalism didn't work and couldn't produce desired outcomes. A regionalism which has worked as planned is the United States of America. It seems to me Europe needs United States of Europe for it to work, People who believe in free labor mobility say we need more integration to solve the problem, but some of those problems are caused by too much integration, which sounds perplexing.

Asia has a completely different model of regionalism. It's market driven, it's outward-looking. These things are almost opposite to the Europe's model. We need to strengthen institutions in Asia to deal with problems we have, but I wonder if we are really ready for it as much as the Europeans are.

Kathuria:

Thank you, Javant. We will collect a few questions before we ask the Ministers to respond.

Omura:

My question is on the social security improvement in the aging society. We tend to focus on positive side of the social security improvement, but what is most important is its pressure on public finance. If I am the decision maker of the policy of those Asian countries, I don't want to repeat the same mistakes of rich countries including Japan. European countries also have been suffering from heavy burden of social security. Do you still want social security improvement which might cause a fiscal burden in future? How should social security burden be avoided?

Kim *(GMMF, Organizor)***:**

The speech of Dr. Awang Adek emphasized the virtues of the Islamic banking and Mr. Meister talked about the lessons that can be learned from the German model. My question is: How much confluence can you find from these two models? The reason I pose this question is because, a rose by any name smells as good, as an English saying goes. I see a lot of models and lessons coming from different countries, so how much confluence can you find in them?

Kathuria:

Before we lose what was the first question Javant made, let me move to Mr. Meister and request to answer the question about the regional integration; Does Europe mean more rather than less integration going forward?

Meister:

Thank you very much. I will go one step back to the year 2008. When the US crisis explored its influences on Europe, I asked myself what would happen in Europe if we wouldn't have any integration at this time. And if you wouldn't have any integration in Europe, each country would have to solve the problems coming via the Atlantic to us. I think Iceland is a very good example. Since it is a very little island in the Atlantic, they are not integrated but are very strongly integrated in its financial market. And what happened? They ended up in complete bankrupt. The same thing would have happened with Ireland, if they would not be integrated into Europe.

First I will state that the regional integration in Europe was not a problem. It was a tool to solve the first part of the crisis. However our problem is, as somebody said earlier today, that integration has been done only partially. We have learned from the second stage of the crisis that we have to complete the integration.

Now the second point. We follow one big principle, the principle of subsidiarity. Everything has to be centralized only when it's not possible to solve it on a lower basis. The principal idea we have is that we will not end up as a central state with one big capital city where all directions come out. We want to reach a stage where everybody could live on his own philosophy. But some central institutions and some common rules are at that point.

If you allow me, I would say something to the second question, which is about social security. Whatever benefit you would receive from social security, it comes from the GDP output. So the answer will be maximizing the GDP of your country. And its key factor, in a long run, should be education. I think all money spent for education is a good piece in the sense for better social security in the future.

I don't think there is any confluence between Dr. Hussin's view and mine. I am not saying that that the German law book should be exported and other countries must write it down. That's not my message. My message was that, our regulation is based on philosophy and philosophy is based on ethic ideas. Philosophy and ethic ideas are what I think is needed behind regulations. Though we surly do have different philosophies, regulations are defined by ethic ideas. Also, regulations will not be merely put on paper but they are what we have to truly live with. I don't see any difference in our message on this point.

Hussin:

I'll just make a couple of comments. Firstly I fully agree with Mr. Meister although it appears different things are being discussed in different countries. I think we share similarities in terms of new things or new challenges facing the world. Priorities of each country are slightly different, but I think the more we work together the better future it will be.

I spoke about the development of Islamic finance in Malaysia, but it is gaining ground globally: 75 countries at present including London, Singapore, Hong Kong and Middle East. The share of Malaysia among the entire banking system is now almost a quarter. The virtue of the Islamic finance is their role as an indispensable part of global finance that addresses the speculative bubbles and excessiveness of the conventional financial system. I suppose that the more the world participates in Islamic finance, probably the less it will be exposed to these speculative activities, which are based on real economic activities.

Second is the regionalism where we stand at present. Considering the experience of

Europe, ASEAN countries should recognize that we have been benefitted a great deal from ASEAN. We are very keen to moving forward to greater cooperation and integration. Of course what is happening in Europe is going to give us some kind of warning on where we go, how we go and at what speed we go. It probably re-orientates our priorities especially in the area of economic integration. By encouraging greater trade and investment within ASEAN, I think it has been successful and should be encouraged. We are definitely moving in that direction. For instance, the ASEAN trade vis-à-vis Malaysia is much more than between Malaysia and Europe because of increasing intra-region trade.

I think we are talking about moving in a way to a single currency like euro, which I think is very far. Anyway I don't think we are going to achieve it in the near future. It is going to make us more or less worry about. I think the idea of moving towards a single currency is a distant issue, which we aren't going to achieve in the near future. But the need to push for greater cooperation and integration is gaining ground.

Fang:
Chair, could I add one thing on the idea of regionalism? When I said we need to see a stronger institution, what I had in mind was the fact that there have been doubts casted by ASEAN critics and skeptics on the prospects of ASEAN in terms of its efficiency and credibility. But ASEAN is moving towards integration of economic community by the end of 2015, and I think we are doing well towards that goal. The point that I would like to make is that we need to lend more credibility to the institution of ASEAN. The institution should be stronger. That is the aim we should seek for.

Ronald:
Just a quick comment on the question of social security and social protection. Indeed there's a lot to be learn from the countries that are already attempting to put this together and I fully agree with Mr. Meister. If I plan to retire one day at age 65 or 70 with some degree of comfort, the thing I would do besides saving money will be government lobbing in order to make sure taxpayers to be very productive, because we will be having less Filipino workers at that point. The taxpayers will be very productive if they are well educated and prepared to compete. That is the main lesson I take from other countries.

Kathuria:
Thank you. I think we are ten minutes overtime so I will not spend time in summarizing. It's been an absolute honor and privilege to be able to host three ministers from three different countries. Thank you very much, Mr. Meister, Dr. Hussin and Mr. Nakao for giving us opportunity to hear your thoughts.

Session 3 - Defining Good Social and Economic Governance: In Pursuit of sustainable Growth and Inclusive Societies

Rajat Kathuria:

The title of my talk is on good social and economic governance, in pursuit of sustainable growth and inclusive societies. I will focus on the topic and use India as an example of the case study, but I will also make a general comment about sustainability and inclusion in the process of economic growth.

Rajat Kathuri

- *innovation has to be a part of sustainability hypothesis because input-led growth is subject to diminishing returns eventually.*

- *in order to be able to continue the sustainable growth in future, it is important to invest in social infrastructure.*

There is an old debate that resurrected in India just a few months ago. It was a debate between growth and efficiency, growth and equity, efficiency and equity. In the previous session, we heard some elements of growing inequity. What is the best way to arrive at inclusive society?

I will give you some numbers so that you become familiar with a kind of economy that I am talking about. Our per capita income is about US$1,500, in purchasing power parity (PPP) terms about US$3,500. But the country's 1.23 billion population are living in extremely different and disparate conditions. Given that, inclusion or inclusive growth becomes very important instrument.

The topic of the debate in India was, "Is growth inclusive or not?" As you heard in the previous session, there seems to be growing inequality associated with growth. The GINI coefficient for India is about 0.38 or 0.39, which is not terribly large. However, that's relative inequality. If you look at absolute inequality, poverty line and a number of people living below the poverty line, the inequality will be very, very high. So the central question is, "Is growth sufficient to pull those people out of poverty?" There was a huge debate. India has democracy of course and some would say it's the noise of it. Some of them would say it's the music of democracy. Whatever it is, growth has had some impact on poverty but is far from enough for a very heterogeneous society.

The debate was between two eminent professors, Professor Amartya Sen and Professor Bhagwati. They debated on the country's growth and poverty. Prof. Bhagwati has focused on growth. His contours of the argument was that, high growth will not only pull people out of poverty, but will allow them to be able to work, will provide the employment opportunity, will provide the state and the resources to implement social security program in case the state is capable to do that.

What has been a proof that growth in India has achieved its objective? There has been some reduction in poverty over the 50 or 60 years since Indian independence, but that has not been achieved enough. People living below the poverty line are of course much less from ten years before but still there are 400 million or 25% of the population.

We had a golden age for growth in India from 2003/4 to 2007/8. Average growth of 9% during those five years was the highest since its independence. How did it happen? There are many reports on this. The success was partly due to greater integration with the global economy, reduction of tariffs and ease of doing business for both domestic and multinational firms. However, the main factor was the increase in investment. Inputs could be labor, investment, capital, energy, materials etc. Our domestic saving rates in percentage of GDP went up from 25% to 34%. Including the 2%, which came from overseas, it amounted to 36%.

How are such growths sustainable? Paul Krugman and other commentators who studied Soviet Union's growth in 1960s and those studying East Asian growth in 1980s have told us that in any country, the only way for sustainable growth is to go beyond the inputs, to be able to have innovations, to be able to improve productivity. It not only owes to governance and institutions but also to innovation.

Now the question is, "Who's driving the innovation?" I am leaving it open for your discussion. If you look at different countries like China, you'll get a certain answer. Mr. Nakao said in the previous session that financial market is public goods. The question I pose is: Are innovation public goods? Are they going to be provided by the state? What is the role of innovation and what is the role of state in innovation? Could we have market driven innovation, or should it be driven by the state because market failure is endemic?

The answer differs by economic models, but one thing which is clear is that innovation has to be a part of sustainability hypothesis or a sustainability story because, as I said, input-led growth is subject to diminishing returns eventually.

I am back to the inclusion story. Growth is not sufficient to improve millions of Indians who live below poverty line. The center of Prof. Sen's hypothesis is that we should not be obsessed with growth. He is emphasizing that, in order to be able to continue the sustainable growth in future, it is equally important to invest in social infrastructure. You would be quite surprised to hear the amount of India's investment in social infrastructure. It's very, very low in both health and education. India has done pretty well in higher education by all accounts, but the country has not done well in investments to improve primary and secondary education. There are many research coming out of MIT on education outcomes in India and one of a new book is by a professor in MIT titled “Benege and Manage the poor”. I will invite you to read it and you will see the result of even the limited primary and secondary education has not been effectively delivered. That’s not only the just an inclusion story but it is also a part of a sustainable growth story. If you don’t have a well qualified, skilled and trained workforce to be able to take part in the growth process, then again the growth is going to hit a stumbling block. It’s going to hit dead-end and that’s precisely likely to happen. The signs are emerging in India where there is a widening gap between skills required and skills available. This is the point Prof. Sen is making.

So it’s not the either-or type of solution. Solutions for moving forward in terms of sustainable growth model and inclusion are to turn the state into an active participant. India have guaranteed National Rural Employment Act, which provides a guarantee for rural employment to households whose adult-members volunteer to do un-skilled manual work not less than 100 days in a year. This has a positive effect on the income of people who are unemployed. That’s the kind of a targeted intervention by the government to improve the living conditions of the people living below poverty, which reflects the government’s ability to intervene where it is necessary.

There are many types of schemes that government of India has in order to address the problem of widespread serious poverty. The final point I would like to raise before I conclude is the ability of state to deliver. Mr. Meister said that a strong referee is needed. In other words, we need a strong government, strong administration. Of course you need to open up the economy and become more market-friendly, more investment-friendly. Simultaneously we have to address the problem of endemic poverty, and to do this you need a government intervention of good quality. There is a weakness in India, not only in terms of government deficit but also in terms of its ability of implementation. You call it crony capitalism, corruption, absence of order or criminal activities. All of that leads to the inability to quickly address the problem of inclusion. I’ll stop here.

Takashi Shiraishi *(President, Institute of Developing Economies-Japan External Trade Organization, President, National Graduate Institute for Policy Studies, Japan)*:
Good afternoon. First of all I would like to thank the organizers for inviting me to this interesting conference. The topic given to us for this session is defining good social and economic governance and pursuit of sustainable growth and inclusive societies. Frankly I am not really sure whether I can say anything sensible about social and economic

governance for inclusive societies especially drawing lessons about global and regional financial volatility we have been experiencing over the last 15 to 20 years. But I am very much aware of the impact of global financial volatility on regional architecture in this region and also the impact on political stability and economic development of individual countries in this region.

Takashi Shiraishi
- *We are aware the region-building of Asia is not intrusive, but network style regional integration. A very shallow integration is becoming more pronounced in this region.*

So in this context, I would like to say something which is in fact missing in the session, namely politics. I would like to make a few points. First, as we all know, the rise of China is a reality. The rise of China combined with U.S. intervention and re-engagement with Asia has profoundly shaped the region. In the wake of 1997-98 East Asian financial crisis, there emerged a regional political project of building an East Asian community. This happened in part to create a mechanism for regional cooperation, especially in currency for liquidity support and to prevent the region from repeating crisis. But also it was an attempt to hedge the American intervention which Indonesia, Malaysia, Korea, and Thailand experienced in 1997-98.

FTAs and EPAs proliferated to promote trade and investment in the region in view of the stalling of the WTO negotiations and the transformation of the regional triangular trade. ASEAN plus three was institutionalized in 1999, and the Chiang Mai initiative started in the same year. ASEAN plus one FTAs and EPAs started to be negotiated and concluded in the early 2000s. In 2006, the East Asia Summit, which is in fact ASEAN plus six, which stands for China, Japan, Korea plus Australia, New Zealand and India also started. All this regional cooperation and collaboration took place with East Asia as a framework and the region meant at least in part keeping Americans out. More recently, however, China's effort to safeguard its security by developing what it considers a reasonable force structure to deter the U.S. has caused a change of security among neighboring states. China's definition of core-interests has also increased in recent years and now includes not only Taiwan, Tibet, and Xinjiang but sometimes South China Sea. It is against this background that China's neighbors have come to be increasingly concerned about China's assertiveness. Although China watchers disagree about its causes the fact remains. China has become assertive in the South China Sea as well as East China Sea.

In tandem with China's increasing assertiveness is the fact that after an absence of almost a decade, pre-occupied with the war on terror, the U.S. has become actively re-engaged in East Asia since President Obama came to power. In Tokyo, for example, in 2009, and again in Australia in 2011 President Obama reconfirmed American engagement in East Asia as a pacific nation. The U.S. will maintain its military presence in this region and has recently announced to change its force balance between the Pacific and the Atlantic from 50/50 to 60/40. The U.S. supports a collaborative diplomatic process for resolving the various territorial disputes without coercion and the U.S. is engaged in "ASEAN plus" processes quite actively. The U.S. has called for a free, fair and open trade in Asia-Pacific with a trans-pacific partnership, TPP, as a model of free trade framework to be promoted. Thus the region of East Asia now finds itself between the superpower and the future superpower. The global financial crisis has accelerated China's rise, military modernization and influence in regional affairs, while the U.S. has responded by beefing up its military presence and re-engaging with East Asia.

These forces have led to friction in the maritime domain and strategic competition for influence. In regional cooperation ASEAN will insist on its status as a hub in regional making whether through ASEAN plus 3 or EAS (East Asia Summit). Recently however in response to the changing regional environment, ASEAN has decided to expand the EAS to include the U.S. and Russia in addition to the previous ASEAN plus 6. ASEAN has also sought to develop regional strategic architecture, such as ASEAN Region Forum and far more important, the ASEAN Defense Ministers' meeting plus processes, which put ASEAN in a position to set agenda and make decisions. So the framework for regional cooperation now varies depending on policy issues. It is ASEAN+3 for financial cooperation, ASEAN+1, ASEAN+6 and TPP for trade and ASEAN+8 for security. China, on the other hand, objects to internationalization of any territorial issues. It does not hesitate to undermine the ASEAN Defense Unity to defend its territorial claims, as you can see in China's recent intervention in the ASEAN Foreign Ministers meeting held in Phnom Penh in July this year.

There was a time when the European experiences were held up as a successful model for regional integration in East Asia, especially to discuss institutional architecture for this region. There were people that also talked about ACU (Asian Currency Unit), but to be honest, no longer. We are aware the region-building of East Asia is not intrusive but is what I call network style regional integration. Very shallow integration is becoming more pronounced.

This is the second point I'd like to make. Political stability and economic development remain to be the most important national objectives practically for all the states in this region. Interestingly, their performance is different from each another. In the wake of Asian economic crisis, fortunes have changed among four ASEAN counties of Indonesia, Malaysia, the Philippines and Thailand. The most surprising turnarounds are

Indonesia and the Philippines. In the wake of collapse, the president Suharto had to haul up. Indonesia's political regime has undergone successful transformation from development authoritarianism to decentralized democratic system. Although Islamist terror remains an issue, politics of identity has been very much localized and contained. Its economy is also back on track, although it took six years for its per capita income to reach pre-crisis 1996 level. But it has grown on average by 6 % a year from 2005 to 2011 and its per capita reached US$ 3,500 in 2011.

The Philippines has witnessed two successful people power revolutions and an unsuccessful urban underclass revolt since mid 1980s. Its politics, I am sorry to say, remains in meshed in electoral politicking dominated by professional politicians and sectoral activists. The Philippines economy grew by 4.5% a year on average from 1999 to 2011, compared to 3.7% a year before the crisis years of 1997-98. Not only has its per capita income rose from US$1,050 in 2000 to US$2,100 in 2011, but far more important is the fact that Philippine net factor income from abroad increased from US$14 billion, 15% of Philippines's GNI in 2000 to US$ 66 billion or 25% of GNI in 2010.

By contrast, Thailand and Malaysia, two more developed successful states before the crisis, with average growth rate of over 9% from 1987 to 1996, have seen their economy decelerated to 3% to 4% a year from 2000 to 2011 amid a political stalemate and global financial crisis. It is in part because their dependence on trade makes Taiwan far more vulnerable to global economic volatility. But it is also in part because these two states are now mired in political stalemate and trapped in the formula of their success. Particular configuration of power in these countries makes it difficult for them to break out of the impasse which they now find themselves in. This formula which has served for both countries very well in the era of export-led industrialization when Japanese and other East Asian multinational companies were moving their production facilities abroad, works less well now in a time when China has emerged as a global workshop offering stiff competition to many manufacturing sectors in Southeast Asia.

In contrast, Indonesia's growth is fueled by commodity exports and by the fast expanding domestic consumption, while the Philippines' economy is driven by the remittances of its deterritorialized labor forces and by the competitive advantage in the human capital. So the questions all these countries are confronted with are no longer the same. The days when the single prescription based on the development of state model was applied to all the countries in the region are gone. Instead, the most strategic challenges Indonesia and the Philippines face are whether the government can initiate a series of policy measures in human resources development as well as infrastructure development to avoid middle income trap in the coming years. Malaysia and Thailand need to break its political impasse and address the unaddressed issues: competition and pork-barrel in Thailand, and the expanding intra ethnic disparity and brain drain in Malaysia. Fortunes of individual states of this region are changing. So is the regional architecture. Given the rise of emerging countries and American reengagement in the region, there is an urgent need to develop better mechanisms for formulating common words and norms to help mediate differences and tensions among the countries in this region. Thank you.

Dr. Heribert Dieter：

It is nice to be talking about a slightly different topic now on defining good social and economic governance. Of course you will expect a German perspective on this topic and I will try to provide that to you.

Current crises have been reminding both Americans and Europeans that we have to think about the sustainability of our economic policies. Currently this is our overarching kind of concern. The fire fighting is continuing and managing the crisis is of course the biggest challenge at the moment for policy makers. At the same time we shall think where we want to stand in 10 years time and what kind of incentives we want to strengthen. Germany seems to be well positioned. We are, however, well aware of the fact that the current good days will not last if we fail to identify risks.

10 years ago, Germany was considered to be a sick man of Europe. David Marsh in the Times said, "Germany is like a gracefully aging Mercedes in need of a tune-up". We had done the tune-up and we showed that things can be changed. That is, relative positions in the economy are not given but can be changed by having the right incentives: where we want to go, what we want to change. I would like to make three points: labor markets, international trade and financial regulations.

I will start with the labor market. In the past we had some debate of extreme positions, basically bipolar debate. On the one hand we had a very flexible "U.S. style" labor market and on the other extreme we had a rigid "Continental European style" labor market. Please let me call them so for simplifying the story. The US approach, hire and fire style was considered to be brutal but efficient. Continental European lifetime employment was considered inefficient but fair and protecting. Today we know that hire and fire is not efficient and that rigid market is not fair. Look at the hire and fire first. It used to be efficient in the economy where factories with single assembly line were viewed as a typical corporate activity. Now it's changing. Hire and fire doesn't work in the complex production structures. In an old kind of assembly line process, human capital didn't matter much. Replacing people in an assembly line was not that complicated. It's different in today's non-standardized production, where human capital expertise and experience matter a lot.

I will give you an example in Black Forest. Last weekend I visited one of those small companies in Southern Germany called Herrenknecht. It is a world market leader in tunneling technology that can drill holes in the mountains up to 19 meters in diameter, and has constructed the so-called Gotthard tunnel which is 60 kilometers long. It is a 30 years old company with 3,800 employees that produce purpose-built equipment. You cannot run such a company with unskilled labor. The company hires skilled workers and retains them even in difficult times. It knows it doesn't have to compete on price because they are so innovative and can pay top dollars to the employees. Germany has learned from its experience that labor markets have to be structured to support those sorts of companies because they are fundamental strength of the German economy not just in recent years but in longer period of time.

So the lesson learned from this afternoon session is that we have to combine two seemingly contradicting goals: flexibility and security. Social security system has to accompany the flexibility of labor market. Unemployment benefits are not just an expression of humanity but are necessary support for workers to embrace globalization and not be too concerned about its negative effects. Without robust social security, the workers in the society may turn away from globalization.

Among other European countries, I will make a few remarks on Italy. Italian economy was once competitive, but its rigid labor market today prevents the country from recovering because they have the labor laws Article 18, introduced in 1970. This article, which guarantees lifetime employment in the private sector, has two drawbacks. The first is the stymied and not very dynamic economy. Companies do not explore opportunities because they are worried to hire people and rather prefer to wait. The second which is making headlines these days, is exclusion of youths from employment and having them waste most of their productive years in unemployment or in precarious jobs. This is the waste we cannot afford in Europe any longer. Youths have to do something in their 20s rather sitting on the couch with parents, friends and so waiting for some lifetime job to come up.

We have the same problem of rigid labor market in Spain too. This September, an Italian editor wrote to me, that the Goethe-Institute, a kind of German culture institution, in Rome, can't provide sufficient supply of language courses for young Italians who consider migrating to Germany. I can assure you they are not migrating to Germany because of the weather. They are considering of going to Germany because the situation in Italy for them is so hopeless. This is not their fault but of those that continue to insist on this rigid labor market that prevents the young people from getting opportunity. To put it in a different way, it is a failure of good intentions. Rather than helping workers in general, those rigid labor laws have helped some and punished many.

Back to Germany: Why did the country do fairly well during and after the 2008/2009 crisis? What instruments turned out to be useful? When the crisis started, there was a fear that it would end in a great global decline, but this hasn't happened. In Germany companies did not sack the people but instead put them in a short-term working contract, which exist in other countries as well though they might be used in less degree. When the demand returned in 2010, those companies did not have to hire new people because they had the people and the skills. They just increased the working hours which helped the economy a lot.

To sum up the first section, flexible labor markets are essential and it is not necessarily to embrace Manchester style of capitalism of hire and fire. Safety net is essential to maintain dynamic spirit in society. This is what I referred to as embracing the globalization.

Second point is on international trade. We have already talked a little about it in this conference. I think one of the analyses that are shared virtually by all economists is that participation in international trade is beneficial. You will hardly find economists suggesting that non-participation is a better option. We know that countries that have integrated themselves in the global economy have fared much better than countries that had shied away from globalization.

We are, however, in the process of forgetting the importance of liberal multilateral trading regime. We see a rise of preferential trade agreements. I call them deliberately "preferential" trade agreements. They are very popular, but they don't do much with free trade. There was a mount of papers on rules of certificate of origin and they make a trade business complicated all over the world. What would this result in? We will see at the end of this process a fragmentation of global economy which is a negative phenomenon from both economic and political perspective.

The world trade hit a new record last year of US$18 billion which is an increase of US$2 billion from 2008. So for the time being it's just a possible danger and not a reality, but the problems we face in the international trading regime is that champions --- U.S. and Europeans, have lost their interest in the multi-lateral trade regime while rising power are not ready to lead. Assessments on whether China should be a leader are mixed.

I will now make my final point on financial regulation. What can we do to tame finance? How can the financial industry be controlled to focus more on its key function --- providing capital for investment? Providing capital is their jobs --- not providing risks. I observe often an inflationary use of the term "systemically relevant". In April 2012, Vice President of the ECB Vítor Constâncio, said, there are 36 systemically relevant banks in the euro zone. This summer, banking supervisors asked ten largest US banks to self-evaluate their status --- if they think they are systemically relevant or not. Surprisingly, none of them considered themselves systemically relevant. Therefore we have to ask ourselves whether this inflationary use of the term "systemically relevant" is an acronym for "has to be rescued by at taxpayers' expense".

Simon Johnson, former chief economist of the IMF published a paper in May 2009 in which he pointed out the domination by the "financial oligarchs", had caused much debate. Even as early as 1998, Jagdish Bhagwati said there's a Wall Street-Treasury Complex in the U.S., which illustrated the influence of financial sector has on policy makers.

The challenge now is to make the financial sector reduce their size and make the financial sector accountable without killing the financial system. This is probably not that easy. I would say the U.S. has provided us with some lessons. It is widely known that the U.S. closed Lehman but it is less known that Federal Deposit Insurance Corporation has closed 448 banks since 2008, including 6th largest American bank. Their approach is to protect savers and wipe-out shareholders capital.

In Europe, we have developed certain fear to implement this kind of market-based approach. But I would suggest that we should follow its simple solution. Financial institutions that are insolvent have to be closed and taxpayers shall not hold responsibility for it. This is a revolutionary statement in Europe these days. I conclude that Europe have to remind themselves of the mechanisms that have made the market economies so successful. It's not too early to start with the implementation of such approach. Thank you for your attention.

Panel Discussion - How to Achieve Sustainable Growth and Financial Stability in the Current Economic Environment?

Nik Norzrul Thani *(Senior Partner, ZICO law, Malaysia /Moderator)***:**

Good evening, Ladies and Gentlemen, This is the last session of the day before the concluding remarks by Mr. Wolff. Let me briefly introduce myself. I am basically a lawyer, and normally a lawyer does not speak unless he is paid. Today I am making an exception because this is for a good cost. The title of our panel discussion as the last one today is, as you can be aware, "How to achieve sustainable growth and financial stability in the current economic environment." I think this is a important perspective and we want to get views of our eminent panelists to see how can we achieve sustainable growth and financial stability amid the current crisis and challenges we face in the economy at this moment. I firstly start with Minister Choi. Mr. Choi, please?

Dr. Jong-Tae Choi *(Minister, Chairman, Economic and Social Development Commission, Republic of Korea)*:

Thank you so much. It's a pleasure to join in this panel discussion. Let me explain about the better governance, in connection with the Korean experience, particularly social perspective and social contact. The importance and the role of social dialogue in Korea will be emphasized as means to seek solutions to ensure sustainable development and to restore financial stability amidst the global economic turmoil.

Over the last 10 years, Korea has gone through three economic crises including the 1997 foreign currency crisis in Asia, the 2008 financial crisis emanated from the U.S., and the 2011 euro zone fiscal crisis that is still ongoing. With its open financial market and high dependency on external markets, the Korean economy has been heavily influenced by the world's economic fluctuation and risk factors.

The 1997 foreign currency crisis in Asia and the subsequent IMF bailout were the most painful experience for the Korean economy. Koreans often refer to it as the IMF crisis instead of the foreign currency crisis. It was the worst crisis for Koreans since the Korean War that broke out in 1950. After the war, Koreans rebuilt the economy from scratch, recording remarkable average growth rate of 6% during the 1960s and Korea became one of the top ten economic powerhouses after being one of the poorest countries around the time of the Second World War. However, this economic miracle lost its shine when the country faced a moratorium in 1997 due to lack of foreign currency to pay back short-term loans.

Jong-Tae Choi
- *that said, there were positive outcomes after the economic crisis: the emergence and development of social dialogue and compromise.*

The country had to receive bailout from the IMF, the U.S. and other international institutions. Yet, it suffered harsh consequences, a high interest rate on loans, flexibility in the labor market and stringent restructuring. The market interest rate exceeded as high as 30% and the rescue packages resulted in tighter fiscal policies, privatization of public enterprises, the opening of the financial market, corporate restructuring and the introduction of hostile M&A as well as layoff system. Korea Exchange Bank, Korea First Bank and other financial institutions and government enterprises were sold off to foreign capital under the name of 'the necessary restructuring.'

This led to significant loss of sovereign wealth. Both labor and the management had to bear the brunt of harsh realities. Although the debts were repaid in three years and the economy rebounded, it left deep wounds in the economy. Though exports and corporate profits recovered to the pre-crisis level, real income of household stagnated or lowered while domestic and foreign capital investors earned handsome dividend payments and capital gains. Due to drastic deregulation in the labor market, the number of irregular workers with low wages and those who own poor private businesses exploded. According to the official government statistics, they stood at 33% and 31% of total workers respectively. In order to make up for the reduction in real income, household debts including credit card-backed or real estate-backed loans skyrocketed. From the late 1999 to the end of 2011, household debt in Korea has increased every year by 12.9% on average. In particular, the poor income bracket had higher debts and was exposed to more risks. The situation could further aggravate if the unemployment rate worsens in the future in combination with the global economic crisis. In other words, Korea had to pay the prices of stunted growth in the business and financial sector and the regressive household and unemployment despite its rebound from the financial crisis.

There were positive outcomes after the economic crisis: the emergence and development of social dialogue and compromise. First of all, Koreans were united as one and participated in the gold collection movement. They voluntarily donated their gold at home and the Korean government sold the gold to repay the country's debt. The movement was a strong symbol of community spirit and it surprised the foreign credit agencies. Even today, countries under economic crisis are taking lessons from the

Korean experiences. At the same time, labor, management and the government agreed to establish a social dialogue body and facilitate an agreement on burden sharing in order to overcome the crisis through active social dialogues. The Korea Tripartite Commission was launched in 1998 as a statutory body and adopted a social pact with labor, management, the government and public interest members to promote comprehensive discussions on reforms and burden sharing across labor, finance, public and corporate sectors. Trade unions returned their bonus payment or voluntarily agreed to freeze or lower their wages. Although there were some confrontations, they also agreed to accept flexible labor arrangements including leave of absence due to restructuring and unavoidable layoff. In return, the management made efforts to minimize layoff from restructuring and to maintain continuous employment despite worsening environment.

In 2007, the Korea Tripartite Commission was changed into the Economic Social Development Commission (ESDC). ESDC also worked on the grand agreement on voluntary wage cut, minimum layoff, support for the poor income bracket and stable labor management relationship when the country was hit by the 2008 global financial crisis. Over the recent several years, social dialogues have focused on addressing bipolarization and instability of the labor market. New legislations were created to rectify discrimination against irregular workers and to protect their right. The coverage of employment insurance was expanded and active labor market policies were implemented through policy discussions. At the same time, working hours were reduced and various solutions were reviewed in order to promote job sharing. As a result of such efforts by all players in the economy for burden sharing as well as by the government to stabilize the financial system, Korea was able to overcome the 2008 crisis earlier than other countries.

However, Korea was again hit by the 2011 euro zone fiscal crisis. As was mentioned, the Korean economy is highly sensitive to the global economy as it heavily depends on external markets. Instability in the financial sector and reduced exports triggered a plunge of the economic growth rate, weakened purchase power, and reduced facility investment. Subsequent decrease in employment and growing unemployment can have large negative effects on the overall real economy. It means that the economic crisis may easily turn into social crisis if there is no cooperation among labor, management, the government and the civic society and if there is no democratic governance. Unfortunately, there are still a number of factors of financial instability and moral hazard including household debt, real estate bubbles and restructuring of unviable savings banks. Furthermore, populist welfare programs before the presidential election in December of this year can set off alarm signals for fiscal stability.

At the same time, sustainable development necessitates changes in policy directions. Market-led globalization over the years generated negative outcomes of weaker household wealth and labor market although it grew the businesses of large conglomerates and financial capital. Therefore, it is time to increase appropriate job opportunities and to increase household purchase power so that both the corporate sector and the financial sector can prosper further. Also, the financial system that caused moral hazard and the economic system that caused the phenomenon of growth without employment have to be addressed and improved. It is important to strengthen social safety net for the working poor, to enhance employment and to make more quality jobs to overcome social bipolarization.

Effective solutions have to be adopted to promote and manage the flow of financial transactions and capital movement across borders as the domestic financial market can be stable when there are appropriate control measures against risky derivatives and speculative transactions.

Based on this solid foundation, participants in the economy have to work together to overcome the economic crisis, to ensure continuous growth, financial stability, balanced budget, the development of social safety net and job creation. The key to the success of this process is social dialogue. In Korea, the financial crisis over the past ten years resulted in mounting social risks, yet it also promoted the efforts for social dialogue to surmount the crisis and social division. The Korean experiences can serve as a useful example that highlights the importance of "social perspective" and "social measures" in combating the financial crisis and in pursuing sustainable growth.

In order to overcome approaching economic crises and to continue sustainable growth, it is imperative to ensure financial stability and balanced budget. This in turn, calls for more social dialogues and grand agreements by labor, management and the government to overcome these crises. In this the social market systems, German subculture system according to three principles, the individual principle, the solidarity principle and subsidiary principle based on market capitalism is very useful for our conception to overcome economic crisis. Thank you for your attention.

Nik Norzrul Thani：

Thank you, Minister Choi. It was very illuminating to see the Korean way of tackling the crises in the past, particularly by the Tripartite Commission. Different actors of the economy worked out together and tried to withhold, shall we say “stand together”, within the economic crises in the past. There are very illuminating lessons for us to learn.

Let me now call a request to Mr. Yoshihiro Watanabe to make his presentation.

Mr. Yoshihiro Watanabe *(Managing Director, Institute for International Monetary Affairs, Japan)***:**
Thank you very much, Chair. Good afternoon, I am very pleased to make a presentation to such a distinguished audience and panelists. My presentation is based on our discussion at the APEC Business Advisory Council which was established in 1996 for the sake of making our recommendation to the leaders of the APEC regions. Some of our recommendations are very much linked to the financial stability and to economic and social governance.

Yoshihiro Watanabe
-From the business point of view, regulations sometimes become too complicated or too extreme and make the business environment very uncertain.

Two years ago in Yokohama, we presented to the leaders of the APEC a recommendation on balanced, inclusive, innovative, sustainable and strong growth on top of trade and investment liberalization and regional economic integration. Due to a financial background, I have worked to form recommendation to support those goals from finance view point.

ABAC sees the present situation as an era of great uncertainty due to the hangover of the global financial crisis and the still ongoing turmoil in the euro zone.

So we ABAC recommend or ask the leaders of the region to take resolute actions to guard against financial and sovereign risks and protectionism, which are not only to ring fence the region but also to help the region to contribute to the growth of the world economy.

Although APEC is a very high growth region, we have a lot of issues to address. East Asia is rapidly aging. Such societies like Japan need job opportunity for senior citizens. Also the region lacks balance between the rich and poor and does not have enough safety net such as pension and healthcare. To overcome these issues we need to foster innovation on top of many challenges ahead. Otherwise we might get caught in a so called middle-income trap.

Our recommendations to the leaders to overcome the current problems are to enhance technology innovation backed by financing and to enhance collaboration with Asia Pacific partnership. For the region to continue solid economic growth, I think it is crucial for the government to make an environment which fully allows commercializing of innovative idea --- for example to make a legal and regulatory frameworks that supports those companies amid stages of innovation. That is venture capitals or angels for an early stage, --- private capitals, equity finance commercial and investment banks for the middle stages and institutional investors for the final stage.

At Finance Ministers' meeting held in Moscow, we made recommendations that we need to have a kind of safety net, especially health and retirement funding, when the population are still young. It will be too late to build up such a system after the society becomes aged. If we successfully make a good funding for health and retirement fund, they will help us to establish a good capital and financial market. Also, those funds can be utilized in building infrastructure which lags behind in this region.

ABAC also recommends public-private collaboration to promote financial inclusion, such as financial access of households and small businesses. In some countries in this region, less than 5% of the population have a bank account. We need to enhance not only the access to finance for households, but also insurance and micro remittances. All of them are very important functions for those people. Financial literacy is the key for enhancement. We will also need to establish financial identity, consumer protection and cross-border microfinance.

Those are what we have recommended to the finance ministers. To cover all issues we have recommended the establishment of the so-called Asia-Pacific Financial Forum (APFF). We are aware that there are already frameworks such as CMIM, Asian Bond Market Initiative in this region. But we don't think those are enough. We are recommending that a trilateral–party forum, which consists of government or public sector, academia, and business people, to discuss throughout the Asia-Pacific region about regulation and capacity building.

The Australian Treasury is kind enough to host such a first meeting to set the goal, agenda, and timeframe and what are the deliverables to be. The forum should not duplicate with the effort of ABMI or CMIM. But involving business persons in the discussion of capacity building and regulatory issues is very important because we sometimes see some development of new regulations might become obstacles of private businesses. Unexpected consequences of Frank-Dodd Act or Basel regulations would be the cases. Basel regulations set a relatively high risk weight for the trade finance. Banks would become more reluctant to provide trade finance due to the regulation and this might prevent small-medium enterprises from accessing sufficient financing who relies its credit on the trading goods or commodities. FATCA is also an example of such an unexpected consequence. I think you are aware of the consequence of FATCA. If it is really applied overseas, we need to report huge amount of documents to the U.S.

Finally I would like to introduce the recommendation that was made two years ago. That is on Islamic finance. Islamic finance is an alternative finance and we think it has a great use as we can increase the access of the Islamic society and also that finance is directly linked to the real economy. I think it is based on the faith. That can be regarded as a kind of business ethics, conscience or responsibility. And equitable contract can be enhanced.

ABAC proposed to enhance market awareness, increase capacity of professionals, scholars and educational institution, and finally to remove the impediments like domestic & cross tax related to the real good transaction. Those are what my presentation and in conclusion I think this kind of dialogue of government, academia and private business circle is very useful to achieve a financial stability in this region. Thank you very much.

Fan Gang:

Thinking of sustainable growth, I have too much to say because too many problems that exists in China. It is a developing country, huge country, large population, big disparity not only in groups but also regional disparity among regions.

Maybe I give some comments. I guess many people are now questioning if China can continue to grow. So I may start with these slowdown and rebalancing issues. Then I will give some comment on the sustainable long-term growth, how we balance short-term urgency and long-term growth.

First of all, Chinese economy is going to slowdown. But I ensure you that this slowdown is policy engineered. After one year's huge stimulus, and the stimulus really resulting in bubble and overheating, Chinese government quickly changed its policy in early 2010 trying to curb down the asset bubble in the real estate market. It's now in the process of soft landing, and maybe not it is at the bottom, but this is very much a cyclical phenomenon, I suppose.

But after all a lot of people say that China is now coming to stage of low growth and say bye-bye to high growth. In terms of high-growth a lot of people mean double digit growth but actually China in the past 30 years, only in very few years enjoyed double digit growth. And whenever China has 9% growth, inflation comes. Whenever we have

10% or above, inflation plus asset bubble come. That means double digit growth is not normal growth, not potential growth. Of course China suffered deflation in late 1990s and under 7% growth. So by these historical statistics we can show that if we come down to 8% growth now, it's good news. 8% is still high growth in the world. So it's not coming down to slow growth, it's still growing. But we need stability. We need to avoid overheating so that we can avoid the crisis.

Secondly about rebalancing. When people talk about rebalancing they talk that China is too dependent on exports. This is a mess. China's growth is actually not much dependent on exports for growth. Value added for export on GDP only accounts for roughly 15 %. In Germany it's normally about 60%, in Japan normally about 30%. China has a long way to go to increase the exports. China will export more. Why Germany doesn't have the surplus issue and rebalancing issue. Because Germany also imports. The problem is that sometimes China does not really import much. Why is that? If China imports much, the trade surplus will be reduced. For example last two years, China actually trade surplus down to less about 2 % but this year although China exports less, the trade surplus will increase. Why? Because domestic market is slowing down and imports become less. The real issue is not export. The real issue is trade balance. How do you achieve trade balance? What the problem in China? I admit this is not an international issue but a domestic issue, because China's saving rate was still too high at 50% of GDP and current consumption is too low. And if you have a 50% of GDP but you don't want to spend it because you are concerned about various uncertainties of the Chinese economy, you will only consume or invest 40%. The result is you have 10% left as a trade surplus. That's the source of the imbalance. So I'm not blaming the others, China has the source of this domestic problem which is challenging in the Chinese economy. Why we have such a high saving rate? Not because household saves too much, it's because corporate sectors saving too much. I'm not going into details too much. Why corporate sector saves too much because household sector earns too little and wages too low. Why wages are too low? It's not government policy placed by law. Because of oversupply of labour. Because China is in the early stage of development and China has 1.3 billion of population. China still has more than 30% of labour force in agriculture.

This is the issues we have to address. How to increase the household income, and how to reduce the corporate savings. This is a real issue. Of the point of view of rebalancing of China, it's not currency issue. We cannot blame others. We have to balance ourselves. That is a real challenge, and this is also very much of social disparity issue. Without full employment, without full completion of industrialization and without transfer and relocation of the Chinese farmers into industry and service sectors, you never achieve equity in the income. That's the bottom line for the developing countries. I think a lot of things are happening and moving toward that direction. In recent years wages are increasing, government is making effort to increase the wages, many local governments set up a minimum wage, quite a high minimum wage, and the central and local governments make their efforts to improve their social security system. As I said in the morning, China is building up its social security system. It will take time. You can't do it overnight but it is improving. So we expect the saving rate will come down in the next five years to 45%, still high, and next five years to 40%, but still an issue. That's my point of view on rebalancing in domestic economy.

And then for the long-term growth. I think the important thing is for the country like China, we have to address various issues in a balanced way, balancing short-term urgency and long-term goals. You have to keep long term goal in mind and have to balance a different interest and different priority. For example in China now social disparity is a hot issue. Environment issue is important, too. And energy. China is energy shortage country. Water is in shortage, land is in shortage. Everything in a sense is all burning issue. But most important thing for the politicians and for the society is social disparity. It's not only the corruption issue. It's fundamental issue of haves and have-nots, directly related to income and jobs.

But how to address these issues is very crucial for China. It is very easy to get into populism. But populist policy is very easy to build up debts and financial instability very quickly. For example if you set up minimum wage or social security standard too high, make the cost too high, you will damage the possibility of employment of those who have not yet got jobs. They are mainly in countryside and still on farm income. Policy makers have to keep this group's interest in mind as a long-term goal. This is a lesson actually from Latin American countries, and from other developing countries. China now comes to the point of middle-income trap. How you can avoid the crisis? If China has a crisis now, financial crisis triggers economic crisis which in turn triggers social crisis. Chinese story will be over. That is really a concern we have to avoid. I think creation of the employment of those 200 million of people takes so many years and it must be a long term process.

Norzul:
We now have the questions and answers session and I'd like to open to the floor.

Komiya *(Mitsubishi corporation, Audience)***:**
Thank you very much for very nice presentations from each panelist. Especially I would like to ask specific questions, one to Mr. Meister and one to Mr. Fan Gang. In Japan there is a very big debate on whether we should continue or not the nuclear or atomic energy dependency. Many people in Japan respect that Germany announced it stopped

to depend on the nuclear or atomic energy for electric generation. Bur some people in Japan also say that Germany can easily get oil and gas through pipeline from Russia. Japan has no pipeline from whichever country Japan cannot buy electricity from whichever country in Asia. And German can easily buy electricity from France which depends on nuclear power. So we wish to ask the Germany to make advice to Japanese people for the energy alternatives.

Second, many people in Japan think that local governments in China, provincial or town or village heavily depend on the finance by the sales of lands. As you mentioned before, the procurement of lands is limited and also if the contract of the land are made on the basis of the economic principle, then it will be good. If it is rather bubble like we Japanese had experienced in 1990s then it will be some bubble to burst. We don't know the actual figures of such amounts of land sales and purchases by local governments. I would like to ask about your view on this issue.

Meister:

Thank you for your question. In my statement I mentioned that we have three basic aims to change our energy system. One is security, one is durability, and affordability. Your remarks of Russia and France don't meet our aim of security. We learned in the past that Russia had sometimes trouble with Ukraine and threatened to close the gas pipeline. So our answer can't be to become too dependent on Russian gas. Second, February this year we have already brought down 8 out of our 19 nuclear power stations. And also February this year, our French friends had problems at the rivers in France because of icy weather. There was not enough water and they really couldn't run the nuclear power stations and we couldn't get electricity from France. They have nuclear power stations but we can't count on them because they can't always produce them. So gas from Russia and nuclear power from France are not our solution. What does it mean? It means first we have to bring up efficiency with which we use the electricity and that we want to do 1 % year over the next for 40 years to strengthen efficiency to use electricity. That's a matter of lots of science.

Second point is we have to have more productive electricity by solar power. 82 million Germans make their private energy change. Everybody does something but we do not have enough coordination. We have to do better coordination and the approach is not set to be decided overnight. Our plan is to do it over 40 years.

Gang Fan:

If the local governments only depend on the sale of land, that's fine. If they don't have land to sell, they just stop spending. The problem is if they depend too much on the banks' lending, that could create the financial crisis. But anyway local governments are a part of the reason of China's asset bubble. China's real estate was overheated last year. They, together with real estate developers, made the land price higher and higher. Currently a whole bubble is calm down. This is not many people know. Many people still say China is in a bubble. It was in a bubble but because of policy, which was really trying hard to bring it down, now it is stabilizing. And the bubble didn't spread over. Bubble in big cities didn't spread over to second tier, third or fourth tier cities. They didn't have big bubbles and now soft landing, -- almost landed. There's no further collapse or something, it's just stabilized.

What's next? Current policy is buying time for more solution. The solution is property tax. China so far has not introduced property tax, which causes speculative investment in housing and real estate market. Also you should provide alternatives for the local government to finance their needs. Property tax is expected to work to reduce speculation and provide local governments with a revenue source.

Now central government is increasing experiment of this property tax in several provinces. Hopefully it can get going in the couple of years to put more stability in the market. Of course even in the U.S. which has property tax, you can still have property bubble if things go wrong. But hopefully this can be one of the stabilizers in the market place and prevent the risks.

Omura *(Oshima shipbuilding company, Audience)*:

My question is addressed to Minister Choi about the Korean economy. I agree with you. Social aspect is very important to increase economic competitiveness. I would like to ask your observation on current Korean situation. I think the Korean president's external job is to increase international competitiveness of the Korean economy in general and also individually, for example, of Samsong. But his domestic popularity rate has been stagnated so low. And looking at social aspect, for example, suicide rate among the youngsters, it is extremely high. Maybe to some extent it's similar to Japan. So do you have concern over the Korean sustainability to increase international competitiveness?

Choi Jung-Tae:

Thank you. First of all, in connection with the competitive power, Korean big companies are leading the economy. As I told in my presentation, Korea is strongly depending on the external market. About 80% of GDP is export and import. Therefore most of the big competitive companies have a strong mind of global perspective. By way of new goods, commodities or industries, they all think of global market, instead of domestic market. In this sense, Korean large companies have strong competitive powers in the global, especially in emerging markets. In this sense, Samsung and other big companies have still competitive power. In my view they have no particular risk in foreign currency positions. But the problem is that we have bipolarization since 1997. Big gap between big companies and SMEs. For example, we have oversupply in the labour market for large companies, but shortage for small and medium companies. This is one of the critical problems. Recently how to link the economic activities of big companies with small and medium companies is one of the top issues with us. I think big companies should try to connect their engagements with the activities of small and medium companies.

Another question I am not cautious you have told about the competitiveness of Samsung. I think big companies have still competitive power. They have global perspectives and mind. At the same time, they can easily employ good human powers.

Norzul:

Thank you very much. I think we will end the session now and we will thank for the panelists and audience for today.


Wolff

Concluding Remarks

Jörg Wolff

Ladies and Gentlemen, after a long day I have the honor to say a few words at the end of this remarkable symposium. It was organized by three institutions and on behalf of them, KAS, IIMA and GMMF, it is a pleasure to wind up this highly interesting day, not only in thanking you very much but also in stressing the many ideas, analysis and recommendations for economic governance responses which came out of the sessions. When I refer to the welcome remarks this morning by Mr. Gyohten and the German Ambassador, the topics of this conference were outlined very precisely. The various sessions, well kept in sequence, were marked by a lot of insights and foresights. All speakers referred to the serious challenges confronting the economies, resulting in a struggle for economic governance to find a balance between fiscal consolidation, imbalances and growth stimulus in a context of unemployment, investment retrenchment, financial market volatilities and limited space for monetary policy. It is a most complex challenge. We debated on how to restore the health of public finances, how to increase incentives for sustainable growth, how to develop a perspective of recovery that can achieve an economic consolidation by fostering longer term growth and the creation of jobs. Concrete policy steps to ensure such a social and economic governance were discussed. Everybody agreed that they are of necessity and importance for most countries in Asia. And this is exactly what the Konrad Adenauer Foundation with our new program on Social and Economic Governance in Asia, aspires to do, namely to provide the forum to discuss and to analyze such important governance issues of practical relevance and of common interest within the region. For today's symposium it was possible to assemble a circle of very high ranking and very brilliant presenters, discussants and speakers. Many of them belong to the partner network of the Konrad Adenauer Foundation. They all came to the point and they enriched us with their vast economic experiences and knowledge as well as broadened our understanding in presenting the pros and cons of the application of economic governance instruments in their own countries. Insofar we got a well founded picture of both the nature and the impact of economic governance possibilities for sustainable growth in financial stability, as difficult and complicated this may be. So I take this opportunity to thank all speakers, moderators and panelists but also to thank the audience here in this room, I was looking around all day and was delighted to have realized by all participants both a tremendous interest and a remarkable attention. I also thank for the excellent questions which were answered in the same excellent way. Today we got quite a lot of inspirations and I am sure that they will find their way into your professional work. Last but not least, I extend my gratitude to IIMA and GMMF for making this symposium possible. I particularly express a cordial thank you to those who organized and cooperated with us and to those behind the scenes who made today's event running so smoothly and efficiently. Of course a thank you goes also to my office, to Thomas, Yoshiko and Naoko. In particular I want to mention the rewarding collaboration with Mr. Sakuma which was marked by mutual trust and whom I owe a special and warm Danke schoen! He has taken no end of trouble to make this event a success. Ladies and Gentlemen, I thank you very much for your attention and wish you a good way back home.

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