Welcome Dinner Speech

2011. 3. 10

Je-Yoon Shin

Deputy Minister,

Ministry of Strategy and Finance, Korea
Honorable Governor Darwin Nasution from Bank Indonesia, Director Singh from IMF, Deputies and delegates from ASEAN+3 member countries, ladies and gentlemen,

I'm sincerely grateful to Bank Indonesia and IMF for a cordial invitation to tomorrow's Workshop and I am so honored to speak in front of the distinguished guests at this wonderful occasion.

Bali is a very popular honeymoon destination for Asian countries, including Korea. As I saw so many newly-wed couples today, I couldn't help thinking that quite a few of Asia's future generations might be conceived in the island of Bali.

I hope we will benefit from the spirit of fertility in Bali, and build a foundation for more prosperous future of Asia at tomorrow's workshop, with future-oriented and constructive discussions.

Ladies and gentlemen,

Until recently it has been widely believed that "free capital flow" contributes to efficient resource allocation between countries.

However, there have been several incidents,

Mexican peso crisis in 1994,
Asian financial crisis in 1997,
Russian government's moratorium in 1999,
collapse of LTCM, and
U.S subprime mortgage crisis in 2008,
that caused 'sudden stop' and subsequent economic recession.
Voices that are concerned over risks of capital inflow are rising.

Last year, the G20, under the presidency of Korea, made a great progress.
The G20 leaders agreed to elaborate macro-prudential policy frameworks,
including tools to help mitigate the impact of excessive capital flows.

Now it is up to us, policymakers,
to work on and provide optimal solutions.

Distinguished guests,
Asian countries have been highly exposed to global financial markets as
capital liberalization continued: too much capital inflow in good times and too
rapid outflow in hard times. Korea is not an exception. Therefore my job was
and still is to mitigate the volatility and to secure stability in the financial
market. The following three questions are harassing me.

# 1, what causes the rapid capital movements in emerging market countries?
# 2. What kinds of capital are risky ones? What other kinds of capital are productive ones?

# 3. What are optimal policy measures to manage risky capital inflows?

We have distinguished scholars, government officials and market players gathered here today, and I have highest expectations for tomorrow's meeting.

On these three questions, I'd like to briefly share my views.

First, regarding cause of rapid capital movement, I'd like to pay your attention to "externalities" that derive from inefficiency in financial and foreign exchanges markets. If both markets are fully efficient, the capital will be channeled to productive sectors. However, in reality, there is no perfect market. So I think "externalities" should be considered as a given condition.

Second, I'd like to categorize risky forms of capitals. Foreign currency-denominated debts tend to be riskier than local currency-denominated debts.

In terms of maturity structure, short-term debts are riskier than long-term debts.

Between stocks and bonds, bonds are riskier.

In sum, capitals are riskier in the following order: foreign currency-nominated short-term bonds and loans, followed by same types with longer maturity, then local currency-denominated bonds, stocks, and lastly FDI.
Third, as for optimal policy instrument, I believe macro-prudential measures should that exclusively work on risky capital. "Right measure on right place" is important. We need to impose levy, such as Piguvian Tax, on borrowers' debts. And the levy needs to be targeted to foreign currency-denominated short-term debts and loans.

In Korea, we designed the recent macro-prudential measures, based on these logical backgrounds. I expect to go into further details at tomorrow's workshop.

Honorable guests, ladies and gentlemen,

the recent statistics on capital flows in emerging markets show that the trend has reversed to net outflow from end of 2010.

The reversal of trend came sooner than we expected.

We need to watch vigilantly whether this change is cyclical or secular.

At tomorrow's workshop, I hope that, in addition to issues regarding capital inflow, we could discuss how to approach the more recent phenomenon of capital outflow.

Once again I'd like to show my appreciation to Bank Indonesia and IMF BKPM for organizing this meaningful occasion.

Thank you.