PLENARY SESSION IV

Moderator

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Panel Speakers

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The Trans-Pacific Imbalance: a Disaster in the Making?

Wendy Dobson (Moderator)

We had a wonderful evening last night, and we are back to reality this morning where our first task is to examine in more detail, trans-Pacific imbalances. This topic has received repeated reference in passing.

I am reminded by one of the observations made by Cheng Siwei on Chinese-U.S. relations, characterized by four Cs. The four Cs are very apropos the topic this morning. First, the issues are Complicated; much of the public discussion tends to be heat-generating rather than casting light on the situation. The imbalances are in large part caused by the domestic policies that affect savings and investment. So our aim this morning is to be Candid and Constructive -- casting light in order to take the right actions to correct the problem and finally to outline how to address the problem. The fourth C is a Cooperative approach and ideally coordinates policy action because the corrections that are required to reduce the imbalances are also the policy changes that need to take place in countries themselves. Long-term domestic interest and policy adjustments are certainly superior to just leaving open the growing possibility of disorderly adjustment forced by the financial markets.

In their introductory comments I have asked the panelists to answer the question which is posed in the title of this session "are the imbalances a disaster in the making?" I have asked them also to address the case for action by governments and I hope that we can have a fairly clear elaboration of four points: (1) What should be done and why; (2) how to do what needs to be done; (3) what is the likelihood that what needs to be done will be done; (4) what are the consequences of failure.

We have four panelists, one of whom was urgently and unexpectedly called away. So I propose to proceed as follows. We will begin with Fred Bergsten whose paper is in your binder*. I encourage you to read it. I have asked Jacob Frenkel who has graciously agreed, to present the highlights of Fred Bergsten's paper. He will be followed by Park Yung Chul, Professor of Seoul National University and one of Korea's gurus on these issues. He will follow with the highlights of his paper which is also in your binder, and I recommend it to you if you have not read it. It is the most lucid and careful analysis of the issues I have seen in a long time. He will be followed by Edward K.Y. Chen, President of Lingnan

* The paper by Fred Bergsten is attached on pages 117-122.

University in Hong Kong, who will present an Asian and Chinese perspective of the issues. Then Jacob Frenkel will conclude with what will undoubtedly be a careful, thoughtful, global perspective of his own.

I think that you will rarely hear a more experienced panel on these issues. By my count, on this platform we have an accumulation of hundreds of years of theoretical and practical experience with policy cooperation. I am not going to take the time to elaborate on our speakers' bios because they are in your folder, and I invite you to consult them at your leisure.

Jacob Frenkel

I am not Fred Bergsten, but I will do my best to present his views. It is a challenge on one hand because normally I am supposed to take a somewhat different perspective than Fred Bergsten. On the other hand, it is a pleasure and in any case it is an easy task because his presentation and paper are as lucid as his character.

So let's start with the title. The title says, "The Trans-Pacific Imbalance: a Disaster in the Making?" His first sentence is, "What are you talking about? There is no question mark. We are in the midst of a disaster that is happening." So it is strong at the beginning and later tries to articulate what the danger is and what the policy prescription is.

It starts by noting the current U.S. deficit is large and rising. Large in historical standards and rising at a rapid pace, reaching now about US$800 billion, which is 7% of GDP, and rising at the rate of US$100 billion per year. This is obviously not only a large number; we are going to go into an unsustainable situation as well because this deficit has to be financed. And he notes that the U.S. needs to finance US$6 billion every working day. That is indeed large, so the question is, "Where does it come from?" It takes two to tango, and it is across the Pacific and arrives to the Asian economies. The counterpart of the very large current deficit of the United States is the current account surpluses of the aggregate of Asia. He then divides among Japan, China, Korea and Taiwan, and Singapore and Malaysia, etc.

There are groups of countries on this side of the Pacific that finance a large amount of the current deficit of the United States. It is an unsustainable situation. Therefore, obviously the responsibility rests on these two parties. This brings him to urgency. The urgency is due to the fact that while it is not bad to finance large current deficits as long as those who wish to finance it and willing to do so, at some stage, the appetite of the Asian countries to accumulate U.S. liabilities will diminish, and in that case, he goes on to say, the dollar will decline sharply, interest rates will rise and he even speaks about free fall and nothing good will come out of it so we have to prevent it. This is unsustainability on the economic front. Then he speaks about unsustainability on the political front, providing an interesting analysis of Congress where the mode is very protectionist and occasionally even irrational. Political impatience will lead to protectionism which is not a healthy reaction. It is therefore essential to prevent it. How to prevent it? By taking action.

He also says the current deficit of the U.S. reflects basically two elements that are responsible for low national savings. First, household savings in the U.S. have all but vanished. Second, the government budget deficit is also large. This being the case, it gives you already a general perspective on how to deal with it. Do whatever is needed to correct it. He notes that savings are not easily corrected through policy as far as households are concerned. But as far as the budget is concerned, this is a policy instrument that can be dealt with policy objectives. It is regarded that it is economically an opportune time for the U.S. to do it because U.S. economic activity is robust. Cutting the budget deficit today will not cause great dangers for the U.S. but will serve to correct the major time bomb. The opposite should happen in Asia. He then focuses in some specific details on China, and in a nutshell he is aggressive as far as solutions. He believes that China needs to adopt an expansionary policy; I will not elaborate. It is in the paper. But, the most important part of this policy is a very significant appreciation of China's currency the RMB up to 25%.

The U.S. should cut the budget deficit, and Asia should have expansionary measures, but most importantly, as far as China is concerned, a very significant appreciation of its currency. What is the role of a setting like PECC or the APEC Finance Ministers Meeting and other fora? He claims that APEC is the most appropriate forum even more so than G7 because this is a problem that affects them as a group, and they can be responsible for initiating the solution.

So this is what Fred Bergsten had to say, and I am sure he would say it with great passion. But I believe I presented his remarks so that the next panelists, me included, will be able to pick up on this one.

Wendy Dobson

Thank you very much for getting us off to a timely start. What Fred Bergsten's paper underlines is the U.S.'s perception of the problem. It is two sided with the Asia-Pacific economies. He underlines the importance of growing political impatience in the U.S. as perhaps driving the aggressive action he prescribes and makes his paper very timely as Jacob Frenkel pointed out in his conclusion because of the forthcoming meeting of the APEC finance ministers and APEC leaders. So now, with the good example of an on-time presentation, I ask Park Yung Chul to address us.

Park Yung Chul

I object to Wendy's introductory remarks on my qualifications as an expert. In fact, I am not that much of an expert on the subject. But I have been going to many of these conferences for the last six or seven months, and I have learned a lot on this trans-Pacific imbalance issue. What I have learned is that our professionals are unfortunately completely divided.

On the question, disaster in the making, Fred Bergsten thinks it is and I feel somewhat uncomfortable in commenting on his paper in his absence, but nevertheless Wendy asked me to say something about it.

Surprisingly many American economists say that there is no problem to worry about as long as Asians are fixed on an export-led development strategy and at the same time are willing to save so much and hold savings in terms of safe U.S. securities. The one study I saw recently suggested that if the Chinese authorities stop sterilizing the capital inflows and current inflow surpluses, the private sector will start buying up, instead of the central bank, U.S. securities so that the currency will not appreciate. This is the state of the understanding of this issue.

On exchange rate policy and a resolution to the global imbalance, I totally agree with Fred Bergsten in that what is needed is simultaneous and coordinated policy adjustments in the U.S. as well as Asia. The U.S. must reduce the fiscal deficit. We all know that at the same time that would not be enough. The reduction of fiscal deficit much be accompanied by the substantial increase in private savings. East Asia should expand its domestic demand. They could pursue some sort of demand expanding fiscal and monetary policy and make some sort of adjustments of exchange rates.

But to reach agreement on this kind of policy package, I think the U.S. and other parties responsible for global imbalances, in fact EU and East Asia, should get together and agree to what each region of the world will do in reducing the global imbalance.

On exchange rate policy, the best minds of the profession are against any exchange rate adjustment in China. I know well-known economists who say that China has absolutely no reason to revalue its currency. Fred Bergsten says that the RMB is undervalued something like 20%. But Chinese authorities and many other friends ask me on what grounds can you say this? On what model or what kind of estimation would give you that kind of estimation? In fact, some studies show that the RMB is undervalued something like 40%. Again, on what reference? And other studies show 10-20%. Last year, as you may remember, the IMF came up with the study showing that the RMB is undervalued by 2%. That was about a year ago. Since then can you imagine that the RMB would have gone up in value vis-à-vis the dollar by 18%? It is very hard to believe.

There is no empirical recent or past study showing that unilateral adjustment of exchange rates on the part of East Asian countries, including China, Taiwan, and Japan, will make much difference as far as the global imbalance is concerned. It will not help a great deal in resolving global imbalance. Suppose that all East Asian countries agree to revalue their currencies simultaneously. Then it is possible that the U.S. imports less from East Asia and exports more to East Asia, including China. But then if the U.S. is unable to reduce the financial deficit substantially or increase private savings, the U.S. will end up importing even more. So the problem is basically the U.S. In fact, Cline's recent book, which came from IIE, shows that a 10-20% appreciation of the RMB will have a very small effect on the trade imbalance between East Asia and the U.S. unless it is accompanied by a substantial U.S. current deficit.

What I am troubled with in Fred Bergsten's argument is unless East Asian countries, in particular China and Japan, are going to revalue their currencies, they should be prepared for consequences because the U.S. Congress will impose substantial import restrictions and other kinds of retaliatory measures. I do not think this is the right approach unless we change the underlying imbalances of inflows of trade and finance involving the U.S., East Asia, and Europe. This kind of retaliatory action will not do any good. At the same time, from my point of view, the U.S. will need to reduce the financial deficit substantially in two to three years. If not, it is very hard to persuade policymakers of China and others why they should take unilateral action.

In my case, I still believe that China must revalue their exchange rate to some extent and that the decision must be left to Chinese authorities. I do not think we should put any kind of pressure on China because we do not know so much about what the impact of exchange rates and for that matter the effect of fiscal expansion in China would be. But, can you imagine? China is growing 10% a year and nobody can figure out how the state would assess non-performing loans and losses of state-owned banks. National debt could be anything. To a country like China, how can you recommend and ask it to run a fiscal deficit or increase government spending? For me, it is very difficult to accept.

So the final question is that East Asia should do something to strongly influence the U.S. Congress and U.S. policymakers. What is important is that the European Union, the U.S., and East Asia, including Japan, China and other East Asian countries, must get together and negotiate the kinds of adjustments that should be made in the three different regions. And find out whether a disaster is in the making or not. That is the only solution. Otherwise, it is just making threats and asking East Asian countries to make unilateral adjustments -- I do not think that is called for and it is not necessary.

Wendy Dobson

Thank you for a very disciplined and insightful presentation introducing some conundrums in prescribing large changes for an economy like China when nobody really knows how those would take place and what the consequences might be. Now, that sets the stage for Edward K. Y. Chen to focus more on Asian perspectives.

Edward K.Y. Chen

My view is not just the Asian or Chinese view. But most likely my view is unconventional and non-mainstream. My view is very close to what Park Yung Chul just said.

Now let me just briefly set the record straight and look at the facts. In my view, the U.S. imbalance question is overemphasized. It is less important and less pessimistic than perceived by many others. When I talk about the U.S. imbalance, I did not use the word trans-Pacific imbalance. I think there are two biased views about this U.S. imbalance.

The first is an overemphasis on East Asia. Looking at the figures of the U.S. imbalance, only 50% is accounted for by East Asia. But why do we not talk about the other 50%? To me, the U.S. has a 17% deficit with Europe, another 10% with Canada and another close to 7% with Mexico. My first point is that the U.S. imbalance is not just trans-Pacific. It is also trans-Atlantic, and it is also trans-American.

My second point is an overemphasis on China among East Asian countries. We must look at two sets of statistics which Cheng Siwei put out yesterday. Nobody pays attention to the statistics published by the Chinese statistical bureau. According to the U.S. statistics, the deficit with China was US$170 billion in 2004, but Chinese statistics say it is only US$80 billion, a half of the other number. Nobody ever raises this question. Why the difference? Why is there such a difference between the Chinese source and the U.S. or IMF source? There are answers for this.

One is the country of origin question. Now, it is unthinkable that China is generating US$80 billion surpluses on Hong Kong. Talking about exports via Hong Kong, the U.S. would count it as China's exports whereas China counts it as Hong Kong's. So this is the first difference.

The second difference is valuation. Chinese valuation is in RMB while the U.S. valuation is in CIF. This is the significant difference between the prices. So I think to be fair the way to judge the deficit is the simple index number we use just divided by two. So the deficit is possibly in the region of US$120 billion you know. That might be close to the truth.

I think there is the overemphasis on China, because, when you look at international trade, you do not look at the bilateral balance. We should look at the multilateral balance. If you look at China's overall balance with the entire world, the surplus is actually is only US$32 billion according to Chinese statistics. It is US$68 billion according to U.S. statistics. It is too small vis-à-vis Japan's US$170 billion and vis-à-vis Germany's US$195 billion. It is only one third to 40% of Japan's surplus and Germany's surplus. Why is there no call for the German weights in the Euro to rise by 40%? Or why is there not a call for the Yen to appreciate by 30%? I think this overemphasis on China is unjustified.

My point is to look at the cause, I say the cause not causes. There is only one cause for this imbalance whether it is trans-Atlantic, trans-Pacific, or trans-American. There is only one cause. The East Asians save too much, the U.S. spends too much; the U.S. manipulates exchange rates; the U.S. keeps too much in the foreign exchange reserves. To me, these all are secondary causes.

The primary cause is the prevailing international financial system after Bretton Woods. As we all know from 1971, the whole world went from gold standard to a U.S. dollar standard system. Now, under the U.S. dollar system, the U.S. dollar is gold. So if I were the Americans, I would spend it like mad. Because whatever we print, whatever bond we issue, it will be as good as gold. It is a natural response to the financial system.

It is difficult to ask Asians of course not to save 50% because they have their cultural and institutional reasons to save so much. And U.S. people have reasons to save zero because of the international financial system. And for Asians, they will keep on accumulating the surplus again because of the prevailing international financial system.

In 1971 when we changed the exchange-rate system, we did not change the institution supporting it. IMF is grossly outdated. It was meant for Bretton Woods. It was not meant for the U.S. dollar standard system. As a result, you get many financial crises such as 1980s in Latin America, mid 1990s in Europe, and 1997-8 in Asia because our world is not coping with the existing international financial system. The lesser countries, the more vulnerable countries in East Asia have no choice but to fill up the foreign exchange reserves. They have fear. They are afraid because financial crisis is no small thing. So everything else is unimportant. If we really want to solve this imbalance, we have to go to the root of the problem to rebuild the international financial architecture. But that is not forthcoming in the near future.

My solutions are totally different from the rest. The solution as I suggested is reforming the international financial architecture. Should the medium and short-term solution be to try to cut the U.S. deficit and to try to have fiscal discipline? Yes. But that is not the most important. As pointed out by Fred Bergsten himself and also by Park Yung Chul, there is a ripple effect if the U.S. is going to reduce its budget significantly. The whole world will face a problem. There will be a ripple and domino effect on the rest of the world, causing maybe a serious recession. So my solutions are very simple.

Firstly, it would be basically up to the U.S., I believe. I do not think Asians can do very much. Park Yung Chul has addressed exchange-rate policy so well. What is the equilibrium exchange rate (EER)? The definition of EER is extremely complex. You get sustainable EER, fundamental EER, short-term EER, and long-term EER, and I do not think you can say the RMB is 25% undervalued. China has been very responsible in exchange rates, I must say. China did not devalue in 1997 while everybody was talking about a possible significant devaluation. This time China is taking the lead in making the exchange rate more flexible. It does not need coordination like the others said because, in Asia, China is now the leader. We look at China after reforming its regime, and it has worked. Exchange rates have to be reformed gradually. Europe's exchange rates were not totally liberalized until the 1990s. Give East Asia time to do it. I think that the process is being set. Fiscal and monetary policy, again, you can see. What can East Asians do? They are growing so fast. The savings rate is so high. Can you change the culture or their institutions? Many countries are already running deficits.

So my final solution would be that the U.S. must be on the supply side. I have three recommendations.

The number one recommendation is from the supply side not the demand side. The U.S. must try to rejuvenate its economy like Japan did some years ago. Japan has been reborn, and now what we want is the U.S. reborn. That is not the first time that the U.S. has done it. In the 1980s after the savings and loan crisis, the U.S. did go through a very significant restructuring, and it worked. So I think the U.S. should review the whole package of policies on the supply side like stimulating investment, R&D, etc.

Second, the way to finance this deficit is to rebalance. For the time being, the major source of financing is portfolio investment, bonds and other short-term and long-term papers. Why do not the U.S. people accept more FDI? Why don't they allow China to go into their different sectors and invest? I think the re-balancing, re-structuring, and re-distributing as a way of financing the U.S. deficit should rely more on FDI.

My last point is on negotiation and not on market retaliation. It is important, as Cheng Siwei said yesterday, to negotiate with China and not to impose unilateral non-market measures. I do not think the U.S. Congress will pass a penalty on Chinese products. China is not Japan in 1985 during the time of the Plaza Accord. China has a big market. If China does not buy Boeings, ships, or Airbus, you just ask how the U.S. producers will react. So I would propose an entirely different direction of looking at the problem.

Wendy Dobson

As you can see, we have received a very useful, and insightful presentation. Now, I will turn to Jacob Frenkel. What I would like to do is for you to take a couple of extra minutes to give us some insights in your introduction of the possible impact of hurricane Katrina on the United States in part because some of the recommendations, like those from Fred Bergsten are based on certain assumptions that may have changed.

Jacob Frenkel

If this conference were held in 1985 or 1987, we would be talking about similar problems or types of problems. I remember that in the second part of the 1980s, when I was with the IMF and Wendy Dobson was the Associate Deputy Minister of Finance of Canada, we participated in the G7 meetings, and there were the same questions: The U.S. has a large deficit. What should be done? And if we are not going to do something immediately, doomsday will happen. This discussion about coordination, cooperation is "déjà vu" with some new features: first, Asia is the part of the equation. Second, globalization is part of the scenery. Third, capital markets are functioning far better. Fourth, we have learned a lot about the exchange-rate system and about the dangers of sticking too long to the fixed exchange rate, and the Asian crisis was one of the manifestations. So why did we not learn from experience? The answer is partly because it is new territory; it is a new world. To highlight, how much should we be somewhat modest and maybe a little bit more skeptical?

Let me list a few clear statements that now we doubt. We are told that a very large deficit, if it sustains for too long a period, pushes up the long-term real interest rate as the government has to finance the deficit. But, if we look at the U.S. large budget deficit long enough, the long-term interest rates has not gone up. They declined. We were told if the oil price went from US$20-30 to US$30-40, US$40-50 to US$70 per barrel that would be a disaster and we could not survive. The world will go under in terms of output if inflation becomes a major issue. We are at US$70 oil price. Inflation has not yet erupted and growth, as Fred Bergsten says, is robust. We are told if you have a very large current account deficit, the currency will depreciate. If the U.S. has a large current account deficit, the dollar should have been falling. Yet the dollar has not been falling. We are told that if the Fed in the U.S. will push up interest rates, eventually the long-term rates will also go up. Well, this has not happened. We are told if the country saves a lot, the capital market will be rewarded. But if the country saves too little, it will be penalized. Well, the U.S. household savings is low, Australia negative, and some other countries negative, and yet, no negative outcomes. We are told that for the well-functioning world, the industrial countries have to export capital to the developing countries. The reality is industrial countries import capital from the developing countries. The purpose of those opening remarks is not to tell you that we should ignore our text books, but rather we should ask ourselves: are we in a new paradigm? We had better examine what is going on really.

The problem today is not in the macro fields. The problem is in the structural policy fields, competitiveness market field, openness market field, regional market field, and labor market field. If we only focus on macro, we will prejudice our own recommendations. If labor markets are inflexible, even if you have the right macro policies and you make changes, labor cannot move from one sector to another. Unemployment will result so you will be told that you failed, but you used the right policy. What you forgot was that you also need a structural measure. I think whenever we come up with the recommendations that have to do with the budget, current account, exchange rate, and monetary policy, please let's not forget structural measures.

Now, you would say, it was said yesterday that policymakers are not having the appetite to deal with structural measures because the political cost is upfront and the benefits are far in the future. Therefore, why should they do it? Well, that is the greatest benefit of globalization in capital markets. The beauty of well-functioning capital markets lies in what the capital markets are doing. It is dominated by experience. It transforms the future into the present; asset prices today reflect our expectation on the events of tomorrow, and things are moving much faster. We are in fast forward mode. As a result, the long run is much closer to the short run than what we believe. Politicians therefore will see the benefits but also see the penalties if they do not carry out the measures. So I am all optimistic but I think we should really focus on the structural measures and the flexibility of the economic system as much as we can. I will now have some remarks from here and there.

First, on the issue of the Chinese exchange rate, I agree by and large with the remarks that were made here. For the policymakers, I can tell you that it is not the way to influence somebody else's policies through public debate. Exchange rate is a really sensitive issue, and one should engage in a dialogue which is less public. For me, policy cooperation does not mean that you decide on what other guys should do. That is not the issue. It should be policy cooperation instead of policy coordination because you cannot deliver coordination. Policy cooperation means that there is a dialogue in the right fora, and that there is greater understanding of each other. You do not need to be identical but you have to understand. That is basically what policy cooperation is for me.

Let me tell you a story. There were two friends, one was Sam and the other was Joe. Sam took a friend for a drive. When they reached a red light, he pressed on the gas and crossed the red light. His friend said to him, “Sam, what are you doing? This was the red light!” And said Sam, “What's wrong? My brother always does it!” At the second red light, he did it again. Then when they got to the green light, he stopped. The friend asked, “What are you doing? This is the green light!” Said Sam, “Well, my brother may come from the other side.” The point is those two brothers do not have to behave in identical way but they need to know the rules of the game.

Let me outline some principles. Those principles are (1) if you are going to influence your partner during policymaking, do highlight the points and recognize he is not going to do anything against his perceived interests, political or economic. So it is important to highlight why it is in their interest to do the right thing. (2) When making changes, you may want to make it in a gradual manner. But how do you convey decisiveness when you do things gradually? The answer is to have a very clear and credible timeline of policy implementation. You do not have to be always up front, but you must have the commitment to the announced path. (3) Remember, two wrongs do not make a right. In the world of protectionism when one country responds with guns in the trade war against other countries, it will be a much worse world. In a world where an eye for an eye is the rule of the game, you have a lot of blind people. (4) We are talking about the systemic issues, not country-specific issues. There is a rule. Systemic issues require systemic solutions. Systemic solutions require systemic mechanism. Systemic mechanisms require structural settings as Karl Kaiser said yesterday in which you have the mechanism to bring it about. What it means is to try to avoid playing chess against yourself, thinking that you are winning against anyone else.

Lastly, I want you to notice one thing on Katrina. Yesterday was the first trading day after the long Labor Day weekend in the U.S. The picture was terrible because the story was terrible. New Orleans appeared to be a place of tragedy -- human tragedy in the way of incompetent crisis management. The markets open and Wall Street has an extraordinary rise of over 100 points, the first triple digit rise in two months. Yesterday, the SMI was published and we saw the very significant rise against all expectations. I want to leave this in the air because when there is a question on Katrina, we have to put it in the economic perspective even though we do not take lightly the non-economic implications.

PANEL DISCUSSIONS

Wendy Dobson

I am going to turn questions over to the panel and ask whether they want to pose questions to each other. But first of all, I am going to pose some questions. Imagine that I am a Canadian policymaker in an international forum, and like good Canadian policymakers, I am really worried about the systemic risks. I am going to ask each one of you to answer the question that is the subject of this panel. Is there any major regional, global financial disaster that could happen? Disasters have a way of happening at the most unexpected worst possible times, so please give me your best estimate.

You have given us some bases for discussion from the short-term bargain that is macroeconomic, to a major focus on longer-term structural changes. I think we all know that structural changes are not something that can be brought about quickly. It is very difficult to do in political terms. So, as Jacob Frenkel has wisely counseled, a bargain is possible, but it cannot be dramatically or quickly executed. It is not based on impatience. It is based on credibility, on constructive dialogue, and on mutual trust. So the underlying question is if it is suggested we need to change the financial architecture and the U.S. has to undertake a whole bunch of structural changes, none of these will happen quickly and in the mean time markets are concerned. So, panelists, what do you think?

Park Yung Chul

First of all, I 100% agree with Jacob Frenkel. He is one of the best minds in economics, and I do not know if there is anything that he does not know. In fact, I hope he stays longer in the policymaking circle. Nevertheless, I am deeply impressed by the deep understanding about the structural issues that we are faced with. On Wendy Dobson's question about whether East Asia is safe, my answer is no. If you just look at what is happening in Indonesia and in the Philippines, their financial difficulties can be very contagious. Edward K. Y. Chen will give a better perspective on China, but the reserves that they hold will not be enough to save them from any major financial crisis. If they lose 20% of reserves no matter how much in reserves they hold, that would be the end of the game. So East Asia is not safe, and in order to make them safer, rather than holding the reserves, they should continue with the institutional reform, structural reform, corporate reform, and financial reform that was embarked on right after the crisis in 1997-8. But surprisingly these countries think they are safe because they are sitting on a huge amount of reserves so the institutional reform has been stopped. I think this is a very bad development in East Asia. What is surprising is why the U.S. and other international communities are not raising issues on this lack of progress in institutional reform in East Asia instead of worrying about their reserves. They should come and tell us that you are not making progress, particularly in the finance sector and corporate sector. As long as East Asia is behind in much-needed reform, I do not think East Asia is going to be safe and any small or large financial turbulence whether it occurs within East Asia or elsewhere is going to create a major financial crisis in East Asia.

Edward K.Y. Chen

My view as I said is less pessimistic. I think we have time to go under certain structural changes we were talking about. As long as we believe in the U.S. dollar standard system, and many countries still have confidence in the dollar as a currency, I think the system will prevail. The only short-term policy we should undertake is not to take unilateral, non-market solutions as are now being considered by the U.S., but to pursue negotiation and gradual changes. Now the risk factors: people can lose confidence over an existing financial institution overnight only if two things happen: (1) a natural disaster and (2) worldwide financial crisis triggered by the failure of major banks, which is unlikely these days. But a financial crisis will not be only regional. So a worldwide financial crisis will trigger the loss of confidence in the financial architecture. This is very dangerous. That would be the disaster in the making. In a quick response to Park Yung Chul, East Asian countries have been doing something. To me, I think we did quite a lot. We tried in the bond market where still there is limited success. We tried to reform the exchange rate most recently in China. We tried to introduce a lot of measures in corporate governance. These were the issues in the forum two days ago. So I think we are doing something. We can do some better work, but we are doing something.

Jacob Frenkel

Yes, you asked about systemic risks. I asked myself what conditions were conducive to past financial crises. It happened when a country had a weak financial system, weak fiscal system, weak information system. Foreign exchange markets were not functioning well. So that combination almost gives you the checklist. Unfortunately, crisis comes without notice. This is why I agree with the previous remarks that the Asian financial crisis has generated many positive improvements in financial, information, and exchange-rate systems.

Second point: we have learned that the key issue is the pricing of risk. The system is built properly on risk-taking by capable entrepreneurs. The concept of moral hazard is a very dangerous one. The fixed exchange rate is another manifestation of moral hazard because the government provides the implicit promise. If the exchange rate changes, no government should defend the wrong exchange rate. This is why I think the likelihood for financial crisis today with the same deficit is less than what it would have been decades ago. The reason is we have now much greater flexibility of exchange rates.

This brings me to China. I think it will be a mistake to define the change that took place in China in July 2005 as only 2%. The issue is not the level of exchange rate. The issue is the exchange-rate regime. The new regime was introduced. It potentially allows flexibility. I said potentially but markets know it might happen now. It would not have been possible to think like that years ago. In this regard, it is an important point.

Finally, you say we have time, but time in policy is not a calendar measure, it is a functional measure. If you do not do the right thing with the time, then you do not have time at all because the market will anticipate and you will hit the wall. But if you have a credible path, you have a lot of time because credibility is another mechanism to extend time.

Very finally, who should do what? I do not want to leave a vague impression. The primary responsibility should be with the U.S. It is on the U.S. because the deficit is so large compared with any single country or in any region of the world. The U.S. economy relatively robust, and there is no conflict regarding doing the right thing for the external balance because you do not necessarily have a significant cost in the domestic balance because you have a thriving economy. Yes, it takes two to tango. Somebody else should be at the table. It will be Europe and Asia. Let's face it. Without the fundamental political will to pursue the right policy in the U.S, we will waste our time. The session on political will today will clarify the issue much more.

QUESTIONS & COMMENTS FROM THE FLOOR

Wendy Dobson

Well, I tried but I am not sure if our answers were as clear as what policymakers would like. But I think we are going in the right direction. I am going to open the floor to your questions. Since time is short, I encourage you to orient questions towards two issues: What is your advice to the finance ministers and APEC Economic Leaders? What should they do? I think we have made a beginning on advice but let's try to do more.

No. 1: Setyanto Santosa from Indonesia

In response to the question regarding trans-Pacific imbalance, it will be a disaster if we do not change our approach of seeing the U.S. as an engine of growth as we believed years ago. We also have to think about India and China. If you look at the growth of foreign reserves, these two countries also tripled in almost three years. So I fully agree with what Edward K.Y. Chen just mentioned. So we can recommend to the finance ministers, first, the organization we have to change within our organization. The second is to reform the revolving IMF institutions in the line with UN organizations. Look at IMF in Indonesia. It is terrible, and I think we can learn from experience.

No. 2: Young Soogil from Korea

First of all, as one of the organizers, I would like to thank the panelists for having an insightful discussion. I think this is a dream team, and I think it would be even more with Fred Bergsten, but then there might have been a fist-fight, which we in the audience would have enjoyed.

I feel very much enlightened for listening through all this but feel as confused as before. I do agree with the rest of the panel with the policy suggestions. But I think none of these are feasible for implementation for many reasons. If the status-quo remains, will there be a disaster? Two of three panelists said there will be no disaster while one said that there could be. If the disaster happens, it begins with the free fall of the dollar. I do not see that translated to an Asian crisis. They have ample reserves and they will defend parities. They can go into recession, but is that the disaster you are talking about? I tried to reflect on the Plaza meeting and what happened. And if there is no concrete suggestion for action to be taken, there is no way but to wait for crisis to come.

No. 3: Narongchai Akrasanee from Thailand

Two years ago when there was at an APEC meeting in Thailand, I was so sure that the disaster was coming. So during the last two years I recommended all my companies to sell their dollars and real estate quickly. They lost millions, because the dollar went up and actually real estate almost doubled, and the interest rate did not go up. I made a lot of mistakes, and I felt my economics knowledge was useless. Then I tried to understand the situation as to why the dollar was not falling very much and long-term interest rates were rising. Maybe that is what the market wants. If that is the case, perhaps Jacob Frenkel can give me lessons on how I can analyze the asset and securities market so that I do not make the wrong suggestion to my company anymore.

No. 4: Kim Jin Hyun from Korea

I would like to make comments rather than questions. I agree with what Jacob Frenkel mentioned on behalf of Fred Bergsten. The disaster is already in the making. I agree with that the solution is in the U.S. deficit. I also agree with Edward K.Y. Chen's point that the trans-Pacific imbalance should be looked at in the global sense not a bilateral sense. But the U.S. is in trouble. The studies done by IEE pointed out all countries with over 3% of deficit could not sustain, and all went had to go to the IMF. The only exception is now the U.S., which has over 7%.

Getting back to Jacob Frenkel with the question, whether the text book paradigms are working or not, that reminded me of the debate between Keynes and Pigou many years ago. Under which terms does the classical paradigm operate? If it does in the long-term, it will eventually be a problem. So my question is: what do we have to do? As you said on the policy issue, the disaster is going to come if we do not do something right. I guess your concern is we are not doing well.

No. 5: Sri Adiningsih from Indonesia

So far, the imbalance we are talking about is concentrated in the U.S. and the big countries. But I do believe that many developing countries are facing the same problem. We are experiencing imbalance internally and externally. If we look at 1997, it is also contagious to the developing countries. I think it is important that these be addressed at the APEC Finance Ministers next meeting.

Park Yung Chul

It is true that Asian economies have made considerable progress in financial, corporate, and institutional reforms for the last seven years. But the progress is not enough. Let's look at the banking sector, non-performing loans, and the percentage of loans in East Asia excluding China. China has 11% of non-performing loans and it is just too high. Even the central and European commercial banks have low non-performing loans, and in the U.S., it is about 2%. So for the last seven years, after so much progress, still they are holding a large amount of non-performing loans. This is one point.

Second, what about corporate governance? Some of the studies I have been seeing say that there is a very little change in East Asia regarding corporate governance. What about introducing and imposing the global best standards in banking, auditing, disclosure, monetary, and fiscal policy and also regulatory reform? There is also very little change. I am not making up this story. I am just quoting some of the studies that have looked into the progress of reform in East Asia. What about the exchange rate? Surprisingly, after the crisis, many countries shifted to free floating. But now, every country, including China and Malaysia, seems to be managed float tied to a basket of currencies. The exchange-rate regime compared to two or three years ago has become less flexible than before. This is the concern I have. I think there are no market forces that are driving and sustaining institutional reform in East Asia, and that seems to be the problem. If APEC gets together to discuss regional economic issues, one will be to review and examine what has gone wrong in East Asia and review the efforts to restructure its financial and corporate institutions.

About the free fall of the dollar, I do not think there will be any free fall of the dollar in the near future. I am sure that the U.S. and other countries will make sure that they maintain the exchange rate. But if that happens, then the interest rate of the U.S. will increase in the long term. Jacob Frenkel said that that may not happen, but if it does, and I think that it will, it would burst the household bubble in the U.S., stop the recovery of the U.S., and lead to global recession.

On East Asia, what will happen if the status quo is maintained? If the countries continue accumulating reserves, money supply and the liquidity of this economy will increase at a much faster rate than in the past. What would be the consequences? The monetary expansion will lead to speculative demand for many types of assets, including real assets, and will increase the real estate bubble that is in the making. When this bubble bursts, be prepared. This is my concern and if there is any policy concerns for the finance minister and economic leaders, there are two things in short-term issues as I said.

They should get together and discuss what adjustment has to be made to maintain current financial stability on both sides of the Pacific on monetary, fiscal, exchange rate policy, and institutional restructuring and see where we are and what steps have to be taken. I am sure that they know what to do. In fact, if APEC ministers pay attention to the trans-Pacific problem, the market will trust nothing is going to happen. On the bilateral issue, why are the U.S. and many international institutions focusing on trans-Pacific imbalance? Let's look at the Atlantic imbalance, which is growing large. The Euro is a floating currency, but the EU is having a hard time with monetary policy. The problem is they believe that monetary policy will not be very effective for the Euro. It is very hard to criticize the EU - whether it is doing enough except to say that Euroland must grow faster.

The second is to look at the rate at which reserves are increasing in East Asia. Total reserves held by ten countries in East Asia over a four-year period have more than doubled from less than US$1 trillion to more than US$2.5 trillion. That is a lot of increase, and the speed at which reserves are increasing is a warning. That is why they are focusing on East Asia. China in my view has not been forthcoming in the dialogue on economic issues with the U.S. and other countries. As for Japan, I cannot say very much because Japanese authorities will say we have done everything the U.S. has asked. This is the current state of the international economic system. So, just get together and discuss issues. It should be the first and sufficient step at this moment.

Jacob Frenkel

Let me start by noting the remark from the floor that "we are somewhat confused". I think you are right. But confusion should not be understood as we could have done better. We have to realize that it is a complex issue. But I think some principles did come up. I will return to this in a moment.

About the financial advice, I think we got a hint yesterday evening from Han Duck-soo, the Deputy Prime Minister of Korea. He was asked about the reserve composition and I think he answered clearly. Yes. We can expect changes, but do not expect dramatic changes. It is not just a political statement. I think it is a profound economic statement. Whatever the reason is for the accumulation of reserves, there are lots of reserves and assets in dollars and it will be adjusted and guided gradually because it will not be interest of anyone to make it quick.

Since we mentioned China already, I want to add one more point. We are all talking about China's surplus with policy prescriptions. The one we talked about is NPLs, non-performing loans, from the banking system, which could be potentially a very long budgetary burden. Before we ask China to expand the budgets in a very expansionary way, remember that there is already an implicit commitment to deal with restructuring of the banking sector, and that is the major budgetary item.

But I am going to say something more important. If you look at the Chinese exports, 60% of the exports are coming from foreign firms. If you look at the supply chain, that is really the key issue. China is running a deficit against all Asian countries and having a surplus with the U.S. Why the deficit vis-à-vis Asian countries? China imports technology or low materials from East Asian countries, processes and resends them abroad. That allows China's surplus. Now, suppose that you do something that will cut the surplus dramatically. Who will pay? All of those Asian countries that are exporting technology and low materials to China who then turns those around to export to the U.S.

So I just want to say be careful of what you wish for China because it could impose great challenges to the other Asian countries. So we really need to recognize what is going on here. It is not just the U.S. vis-à-vis China. It is China vis-à-vis the rest of East Asia. I just described the extraordinary inter-dependence within Asia. China and the rest of the East Asia have a lot in common. To address the question, if the U.S. policy suddenly changes and Chinese exports to the U.S. diminish significantly, it will impact the whole of Asia. How are you going to handle that?

Now, as I answer the question of the friend from Indonesia, yes, the major engine of growth is China, Indonesia, and India. Asia is growing rapidly, and it is an important part of the world. The relation with the U.S. is very complex. For Asia, what are the common policies and interests that need to be identified?

In spite of the differences, there are some commonalities of interest. Let's identify concretely. Let's shift the debate between the U.S. and Asia from exchange rates into a more global relationship between equal partners. The interest of the U.S. is dominated by Washington's considerations, and all foreign policy is domestic policy. But the interests of Asia should also be taken into consideration without the use of intimidation. So this is the way I would say define the policy. Define the stake, and then invite your partner to the table and say, "Hey, this is where we stand. Let's discuss. Tell us what you can do about it. And we will tell you how we can best cooperate with each other."

Edward K.Y. Chen

Very quickly, I want to address what the Chairperson asked. As I said, there is not much except the U.S., and I think what the APEC Finance Ministers should do is not do a number of things: (1) do not take any anti-trade measures, protectionism measures to resolve the imbalance, or unilateral action; (2) do not be so hopeful about expansionary policy in China or in other parts of Asia. Even if they take the policy, it will not benefit the U.S because Asia will not buy U.S. consumer products. They are not competitive to the lower echelon, and the upper echelon will go to Europe. Even in entertainment today, Asia will go to Korea not the U.S. The only technology we want is weapons, but the U.S. will not sell. So there is not very much we can buy from the U.S. So do not be so hopeful about the expansionary policy because domestic policy is very complicated. Lastly, (3) do not impose on others exchange-rate policy. I think this is an obsession among policymakers and economists. Remember, exchange rates, equilibrium exchange rates, are defined by both internal and external balance. What China did on July 21st may not be entirely for external balance. If you undervalue your currency for a long time and you have an overheated economy, it is necessary to keep internal balance in order to rebalance your currency. After all, the July 21st action was not revaluation but a change of the regime, so a lot of things will happen and come up. That's it.

Wendy Dobson

Thank you. We have come up with the need for a policy package that is much more complex than perhaps we expected. There has been a great deal of emphasis on the need for authorities to recognize the need for domestic policy changes. They should respect each other's policy agenda, embark on a series of policy discussions, and let the market know that there is a process underway. I think there was a unanimity here that that would be the signal that markets are looking for at the current conjuncture.

What we do need is a credible, orderly sense that the imbalance will be unwound. I think the ideas put forward here is that market-forcing adjustment can happen at any time, but we need to help authority to get the right message on a timely basis. Please join me and thank the panelists for a lively discussion.

THE TRANSPACIFIC IMBALANCE: A DISASTER IN THE MAKING?

C. Fred Bergsten
Director, Institute for International Economics

The Problem

The title of this session is "The Trans-Pacific Imbalance: A Disaster in the Making?" I would submit that the disaster is already occurring and is likely to become much worse unless substantial remedial action is taken promptly.

The facts of the situation are well known. On the eastern shore of the Pacific, the United States is running a global current account deficit that has now reached an annual rate of almost US$800 billion-7 percent of GDP, the same ratio that ensued in Mexico before its crisis in 1994 and in Thailand before it triggered the Asian crisis in 1997. The US deficit is rising by about US$100 billion per year so its trajectory is even more unsustainable than its level.

To finance these deficits, as well as its own outward foreign investment, the United States must borrow about US$6 billion every working day from the rest of the world. The net foreign debt of the United States reached US$2.5 trillion at the end of 2004 and is climbing by more than 20 percent per year. The annual deficit must be cut at least in half to stabilize the ratio of US foreign debt to GDP and thus restore a modicum of sustainability to the situation.

On the western shore of the Pacific, the Asian countries are running half or more of the counterpart global surpluses (Table 1[1]). They are piling up massive foreign exchange reserves, accounting for 90 percent of the increase in world reserves over the past three years (Table 2) and financing most of the US deficit. Japan has been running the largest surplus in absolute terms (about US$150 billion) but China's surplus may be even larger this year, has been rising the most rapidly and is far greater as a share of its economy (probably $7^1/_2$ percent in 2005). Taiwan and Korea, respectively, hold the world's third and fourth largest reserves-both over US$200 billion. Hong Kong, Malaysia and Singapore all run sizable surpluses and have accumulated large reserves as well.

The US deficits and the Asian surpluses are thus opposite sides of the same coin. Neither can decline significantly unless the other does so as well. The central issues are:

- **Whether adjustment is really necessary or whether the status quo can continue to prevail?**
- **If adjustment is necessary, what will be its nature and its distribution among the key countries?**
- **Which countries need to initiate adjustment measures to achieve an orderly correction?**

1. The IMF estimates for 2005 (and almost certainly 2006) in Table 1 are already outdated. The US deficit ran at an annual rate of US$780 billion in the first quarter and China's surplus is likely to hit about US$145 billion for the full year.

The Need for Immediate Action

Most observers focus on the international financial unsustainability of the present situation. The United States cannot indefinitely finance annual external deficits rising rapidly toward US$1 trillion per year. Foreign private and even official investors will at some point become unwilling to invest the needed amounts at current exchange rates and interest rates. The dollar will then fall substantially and US interest rates will rise, perhaps sharply in a disorderly "free fall." This would be highly disruptive for the United States itself due to higher inflation and interest rates, which in turn would tank the equity and housing markets and thus the overall economy. It would be costly for the Asians as well due to the parallel reduction in their external surpluses, on which many of them continue to rely for much of their economic growth. Such a scenario could begin to occur at literally any moment.

There is also a second, domestic US political, unsustainability in the situation that has already begun to hit and leads me to conclude that "the disaster" is already well underway. We know from the history of trade policy that dollar overvaluation and the large external deficits it produces are by far the best predictors of protectionism in the United States (and Europe) that can threaten the entire global trading system. It was the first surge of postwar protectionism in the United States, not any collapse of foreign financing for the US deficits of the day, that led President Nixon and Secretary Connally to force dollar devaluation in 1971 by imposing their import surcharge and taking the dollar off gold. The soaring dollar and record trade deficits of the 1980s led Congress to be ready "to reinstate the Smoot-Hawley tariff itself," as Congressional leaders said at the time, and prompted President Reagan and Secretary Baker to initiate the Plaza Agreement in 1985 to drive the dollar down by 50 percent and to adopt much tougher trade measures against Japan.

We are seeing a repeat of that situation today. Despite the strength of the US economy, which is currently approaching full employment, widespread import controls have been applied to six Chinese industries over the past year. The House of Representatives passed anti-China economic legislation in July and essentially vetoed the proposed CNOOC takeover of Unocal. A spate of trade disputes have erupted with the European Union and other trading partners as well.

I outlined in my remarks yesterday[2] <u>the enormous consequences for the world trading system, the Asia Pacific region in particular and especially US-China relations of this domestic US political unsustainability of the present imbalances</u>. The Senate is ready to pass the Schumer Amendment, which would levy an across-the-board tariff of 27.5 percent on all imports from China until they revalue substantially. The Administration will almost certainly have to label China a "currency manipulator" in its October report to Congress, and launch an aggressive campaign of its own to persuade China to act, or risk triggering even

2. C. Fred Bergsten, "A New Strategy for APEC," remarks presented at the 16th General Meeting of the Pacific Economic Cooperation Council in Seoul, Korea on September 6, 2005.

stronger Congressional reactions. The international financial unsustainability of the situation, described above, could erupt at any moment. Hence urgent remedial action is required.

The Steps Required

Responsibility for the huge imbalances of course rests to a large extent with the United States as the deficit country. The underlying cause of the problem is America's abysmally low national saving rate, particularly the huge budget deficit of the Federal Government and the virtual absence of private household saving. Hence the United States relies on foreign capital to finance much of its economic growth and must run the counterpart large current account deficits that cause so many problems.

The US budget deficit will decline by a welcome US$100 billion or so in the current year. However, it is likely to rise substantially in the future unless major new policy actions are taken-as opposed to the above-budget increases in several areas of spending just voted by the Congress and signed by the President, the prospect of sizable further tax cuts over the coming year or so, and the absence of any plan to check the sharp increases in entitlement spending (especially for health care) that are inevitable as the population ages rapidly. The US Government needs to restore the budget surpluses that the present Administration inherited when it took office five years ago. We do not know how to increase private saving but the continuing steady rise in interest rates will presumably dampen spending on housing and other interest-sensitive sectors so could well move in that essential direction. <u>Now is the time for the United States to address these issues since the economy is growing so strongly</u>.

The result of such adjustments in the United States will be a reduction in the growth of domestic demand, offset partially over several years by a reduction in the external imbalance. This will of course weaken the US growth impetus for the rest of the world. The corollary in East Asia will therefore have to be an increase in domestic demand to counter the decline in external positions.[3] China is fortunately running a very large budget surplus, as well as enjoying very high rates of private saving, so should be able to couple the sizable appreciation of the renminbi that is so badly needed with a substantial fiscal stimulus and increased private consumption, to maintain rapid expansion in the short run by boosting domestic demand and to promote the country's essential long-term shift from export-led to consumption-led growth. <u>Mishandling of either the deficit or surplus sides of the equation will lead to a decline in global growth and even a world recession</u>.

An essential instrument for achieving these changes in the two regions is a substantial realignment of exchange rates. Our studies at the Institute for International Economics[4] suggest that <u>the dollar remains overvalued by at least 20 percent against a trade-weighted average of the currencies of its main economic partners</u>. The dollar's trade-weighted decline of about 10 percent in 2002-04 took place almost

3. Europe has been running modest external surpluses and will also need to expand its growth of domestic demand, through both structural reforms and easier monetary policy from the European Central Bank.
4. C. Fred Bergsten and John Williamson eds., *Dollar Adjustment: How Far? Against What?* Special Report #17, Institute for International Economics, 2004 and *Dollar Overvaluation and the World Economy*, Special Report #16, Institute for International Economics, 2003.

wholly against the floating currencies of Europe, Canada and the Southwest Pacific and the remaining adjustment should come primarily against the currencies of East Asia.

Asian exchange-rate policies have severely exacerbated the problem. The Chinese renminbi has depreciated by about 10 percent over the past three years by riding the dollar down against most other currencies, further strengthening China's international competitive position. Most other Asians, fearing losses of their own competitiveness against China, have intervened heavily to keep their supposedly floating exchange rates from rising nearly as much as market forces wanted. Hence a number of Asian countries, most obviously China and Malaysia but also Japan prior to March 2004, have been guilty of violating their IMF obligations to avoid "competitive undervaluation" and "manipulation" of their currencies-as reflected in their "large, prolonged and one-way" intervention in the markets.[5] Calculations at our Institute for International Economics suggest that the renminbi is undervalued by at least 25 percent and that such a rise in its value, along with a parallel rise in the other currencies in the region, would cut US$100 billion per year off the US current account deficit while avoiding any significant change in competitiveness among the East Asian countries themselves.[6]

China took a welcome first step toward correcting this situation by revaluing the renminbi in late July. However, the 2 percent amount of the step was far too small to have any appreciable impact nor is there yet any discernible effect from the announced adoption of the basket peg.[7] China will have to revalue by at least 10-15 percent, preferably 20-25 percent, to offer a prospect for meaningful adjustment and therefore to avoid sharp US (and probably European) protectionist reactions and a likely crisis in economic relations between the world's two leading growth locomotives.

A Role for APEC and the PECC?

The APEC Finance Ministers are meeting here in Korea over the next two days. In light of the centrality of the US deficits and Asian surpluses to the global imbalances, they are in a better position than the G-7 Finance Ministers or any other existing group to initiate the policy measures needed to start correcting the situation.

We at PECC XVI should urge them to do so. If they do not, we should recommend that the APEC Leaders meeting in Busan in November instruct them to do so or begin the process themselves. Both the world trading system and the world economy are at grave risk if they do not.

5. The International Monetary Fund identifies such intervention as a key factor in assessing the existence of "currency manipulation." Taiwan has been guilty of the same behavior but is not a member of the IMF.
6. See Morris Goldstein and Nicholas Lardy, "China's Role in the Revived Bretton Woods System: A Case of Mistaken Identity, "WP 05–2, Institute for International Economics, March 2005 and Morris Goldstein "The International Financial Architecture," in C. Fred Bergsten and the Institute for International Economics, *The United States and the World Economy: Foreign Economic Policy for the Next Decade*, Institute for International Economics, Washington DC, January 2005.
7. See John Williamson, *A Currency Basket for East Asia, Not Just China*, Institute for International Economics Policy Brief No. 05–1, Washington DC, August 2005.

Table 1

Global Current Account Balances of East Asian Economies and the United States (in billions of US dollars)

Country	2002	2003	2004	2005est	2006est
Brunei	3.1	3.8	4.2	4.6	4.2
Cambodia	0.0	-0.1	-0.1	-0.2	-0.2
China	35.4	45.9	70.0	76.5	81.3
Hong Kong	12.6	16.2	15.9	16.3	17.0
Indonesia	7.8	7.3	7.3	6.3	2.7
Japan	112.6	136.2	171.8	157.2	173.1
Korea	5.4	12.1	26.8	26.1	23.1
Laos	-0.1	-0.1	-0.2	-0.2	-0.3
Malaysia	8.0	13.4	15.7	17.4	16.9
Myanmar	0.1	0.0	0.0	-0.1	-0.1
Philippines	4.4	3.3	3.9	2.4	2.0
Singapore	15.7	27.0	27.9	27.2	28.7
Thailand	7.0	8.0	7.3	3.5	2.8
Taiwan	25.6	29.3	19.0	22.6	21.9
Vietnam	-0.4	-1.8	-2.0	-2.3	-1.9
Total	237.3	300.3	367.4	357.4	371.1
Share of US CA deficit	50%	57%	55%	49%	49%
United States	-473.9	-530.7	-665.9	-724.5	-749.8

*Source : International Monetary Fund, *World Economic Outdook*, April 2005.

Table 2

Foreign Exchange Reserves (in billions of US dollars)

Country/region	End of year 2001	End of year 2004	Dollar charge 2001-04	Share of total	Percent change
Total	1685	3105	1417	100	84
Industrial, non-Asia	330	358	27	2	1
Euro area	208	179	-29	-2	-14
Canada	30	30	0	0	0
United Kingdom	32	39	8	1	22
Australia	16	34	17	1	113
Sweden	13	21	8	1	62
Switzerland	30	54	23	2	80
Asia	1158	2396	1238	90	107
Japan	388	824	437	31	112
China	212	610	398	28	188
Taiwan	122	242	120	8	98
Korea	102	198	96	7	94
Singapore	75	112	37	3	49
Hong Kong	111	124	12	1	12
India	45	125	80	6	178
Malaysia	30	65	36	3	117
Thailand	32	49	16	1	53
Philippines	13	13	-1	0	0
Indonesia	27	35	8	1	30
Latin America	128	180	51	4	41
Mexico	44	63	18	1	43
Brazil	36	53	17	1	47
Argentina	15	18	3	0	20
Venezuela	9	18	9	1	100
Chile	14	16	1	0	14
Colombia	10	13	3	0	30
All others	70	171	101	7	144
Israel	23	27	3	0	17
Saudi Arabia	15	23	8	1	53
Russia	33	121	88	6	267

Source : International Monetary Fund, *International Financial Statistics*