

**Japan-China-Korea (A3) Conference
Monetary and Financial Cooperation in the Region**

Handout



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Comment on:

Reasons and impacts of Euro crisis and implication to Asia

(by Guoquiang Long)

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Causes

- There are many contributing causes to the European crisis
 - The common basic cause is the monetary integration
 - Also, eventually the main cause took a form of public debt crisis
- But underlying causes leading to the debt crisis are different among countries
 - One group
 - . Chronic public problem – structural deficit
 - The other group
 - . Real estate bubbles – sudden worsening of deficit

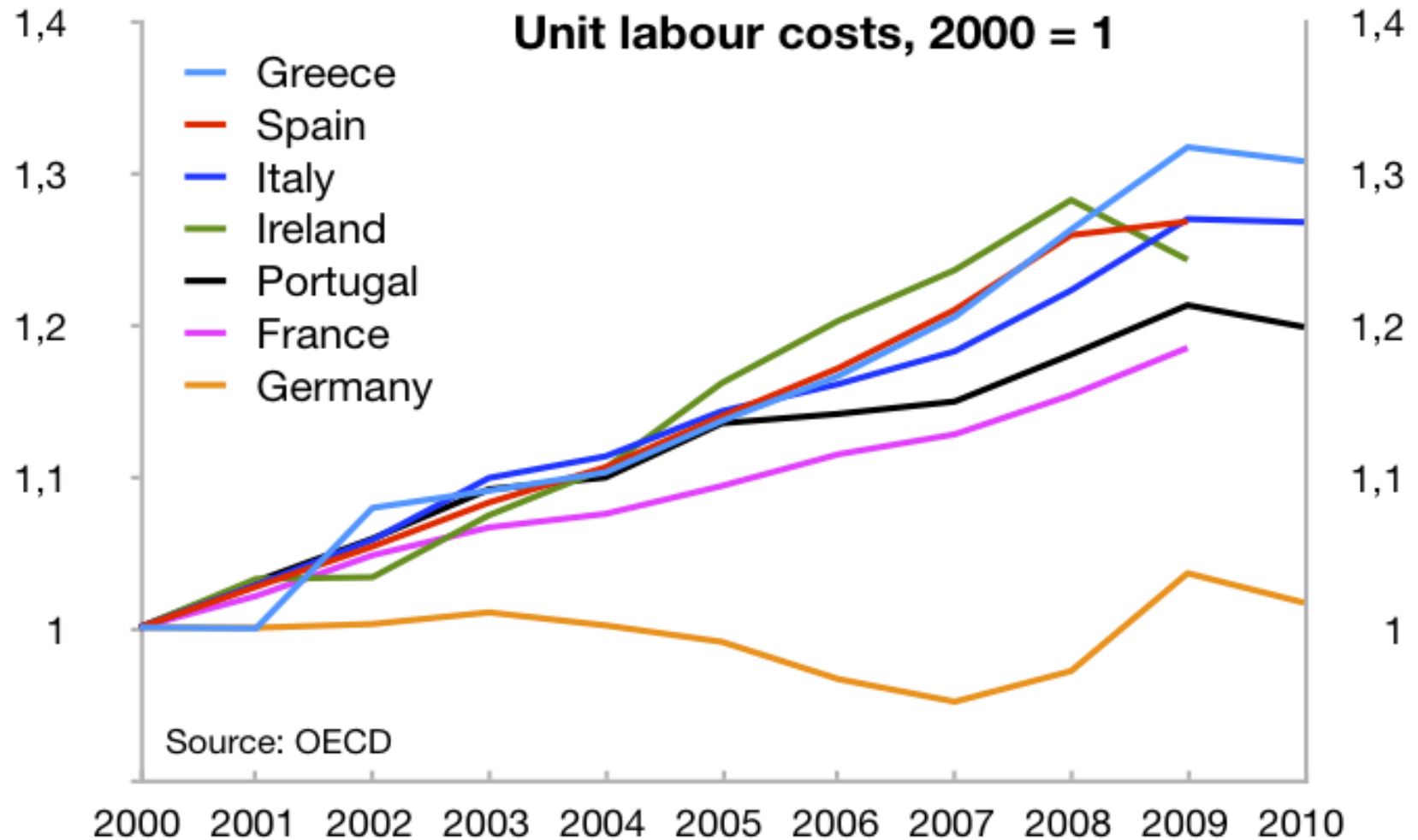
Causes

- Chronic public problem and loss of competitiveness:
Example – Greece
 - Too lax social welfare and endemic tax evasion, leading to chronic public deficit and CA deficit
 - . Unit cost was relatively higher, leading further CA deficit
 - Under eurozone, borrowing cost dropped drastically: government used cheap credit to pay for public and CA deficits
 - . Under eurozone, it was not possible to reduce competitiveness gap through exchange rate adjustment
 - . Other measures such as wage reduction, fiscal restraint or technology improvement were not feasible either

Public pension schemes

	Statutory retirement age (men/women)	Contribution period for full pension (years)	Reference period for benefits	Average benefit accrual rate	Average pension level ¹	Average pension wealth ² (men/women)	Indexation of benefits
Greece	65	35	Last 5 years	2.57	95.1	14.2/16.6	discretionary
Canada	65	40	Best 34 years	0.63	41.6	6.4/7.4	prices
France	60	40	Best 25 years	1.75	50.1	9.0/10.4	prices
Germany	65	not applicable	Career	1.00	36.9	6.7/8.0	wage
Italy	65/60	not applicable	Career	1.75	67.7	9.9/10.8	prices
Japan	65	40	Career	0.55	33.5	5.5/6.3	prices
Portugal	65	40	Career	2.00-2.30	55.4	8.1/9.5	prices with additional adjustments ³
Spain	65	35	Best 15 years	2.90	75.6	11.3/13.4	prices
United Kingdom	65	44	Career	Flat-rate	30.0	4.5/5.2	prices
United States	67	35	Best 35 years	1.20	40.2	5.7/6.7	prices

Unit labor cost



Causes

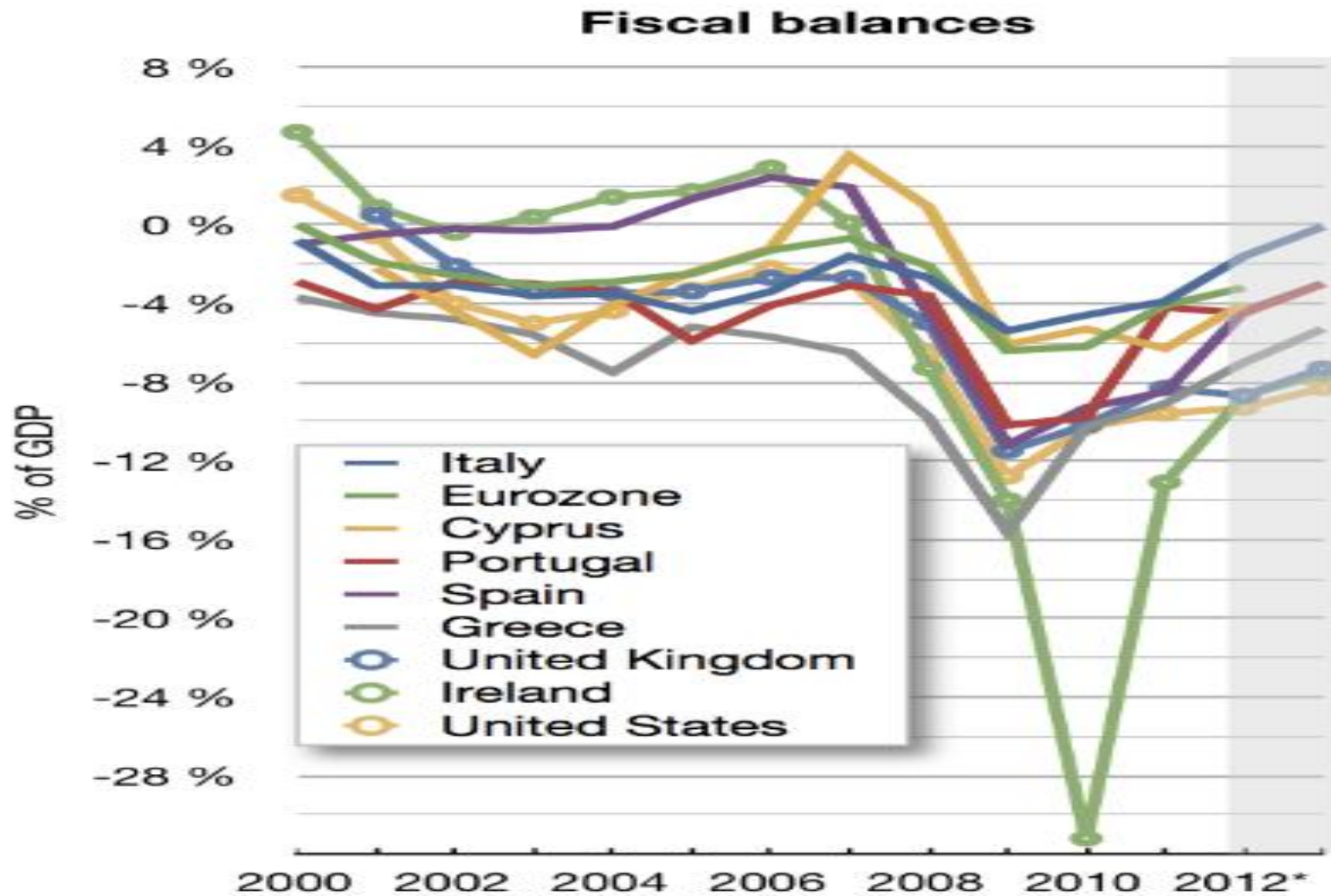
- Real estate bubbles: Example - Ireland
 - The Irish sovereign debt crisis was not based on government over-spending, but caused from the state guaranteeing main Irish-based banks who had financed a property bubble
 - . The Irish economy expanded rapidly during the Celtic Tiger years (1997–2007) due to a low corporate tax rate, low ECB interest rates, and other factors
 - . This led to an expansion of credit and induced a property bubble which petered out in 2007

Causes

- Real estate bubbles: Example – Ireland (cont'd)
 - Irish banks, already over-exposed to the Irish property market, came under severe pressure in September 2008 due to the global financial crisis of 2007–2010
 - . On 29 September 2008 the government issued an unlimited bank guarantee in favour of 6 banks that was to cost much more than the government estimated, and fiscal balance drastically worsened
 - Under eurozone, preemptive restrictionary policy was not possible to calm down overheated bubble economy

Fiscal balance

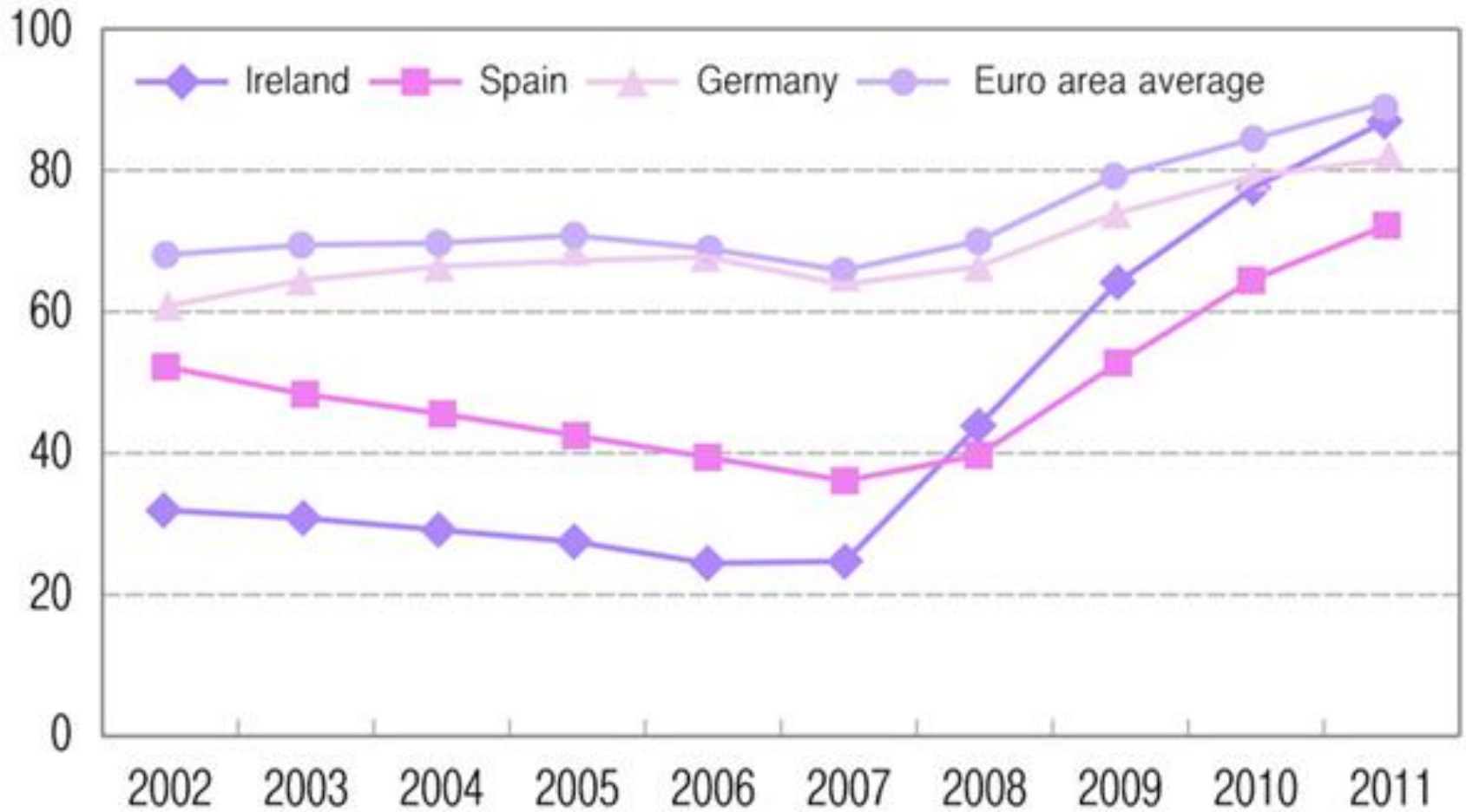
(% of GDP)



Source: Eurostat, IMF and Global Finance Magazine
* 2012-2013 estimate

Public debt

(% of GDP)



Policy Suggestions

- Expansion of domestic demand (share)
 - Concept of "domestic"
 - Concept of "demand"

Policy Suggestions

- Meaning of domestic
 - “domestic” usually implies the market within individual country
 - . Then policy suggestion is reduction of openness
 - . This may lead to support of protectionism
 - Interpret “domestic” as the market within East Asia region
 - . Then policy suggestion is expansion of regional market
 - . This can strengthen rationales of regional cooperation

Policy Suggestions

- Scope of demand
- “domestic demand” usually implies total spending by domestic residents
 - . Then policy suggestion is increase of consumption and investment
 - . This emphasized only the real side and may not provide suggestions to overcome the Achilles heel of East Asian region – financial weakness
- “demand” must include not only real but also financial side
 - . Then policy suggestion is increase of share of neighboring East Asian countries’ financial assets in their foreign asset holdings
 - . This can strengthen rationales of regional financial cooperation

Outbound portfolio flows of East Asian countries

