

Challenges For APEC In The Post Global Financial Crisis Era

Summary by Ken Waller, Director of the Australian APEC Study Centre at RMIT

Mr David Murray AO, Chairman of the Future Fund, addressed these challenges in the 2009 APEC Study Centre Lecture series in Melbourne on 1st December.

This note records some of the key points of the lecture.

Drawing on his experience as chairman of the APEC Business Council's Advisory Board (ABAC) Finance Working Group during the Asian financial crisis, he noted the shock to Asian businesses over the severity and the speed of contagion of that crisis. At that time, ABAC advised APEC Leaders and Finance Ministers of the need to improve macro-economic policy frameworks, to improve risk management in banking systems, to price and allocate risk to reflect the cost of capital and that risk allocation should be supported by effective governance arrangements. He observed that similar advice was now being provided to governments by the G20, the IMF and the Finance Stability Board.



He noted that the Asian region is weathering the global financial crisis, and this based on a number of factors, including improving current account positions over the last decade, greater exchange rate flexibility, some improvements in major global imbalances and the fact that financial systems in the Asian region are generally more robust than they were a decade ago. APEC had contributed to the strengthening of regional financial systems through a range of capacity building initiatives, including those developed by the Australian APEC Study Centre, to support institutional reforms and to deepen markets.

He commended APEC for the success that had been achieved in promoting the conditions for growth, stability and economic integration in the region. Successive Australian governments had provided bipartisan leadership in promoting APEC as the region's major economic forum.

While pursuit of the open trade and investment goals APEC had set for itself were not easily attainable, he commended APEC's influence in helping contain any immediate break-out in protectionism in the global financial crisis. Economies realized the dangers of retaliatory action at this time.

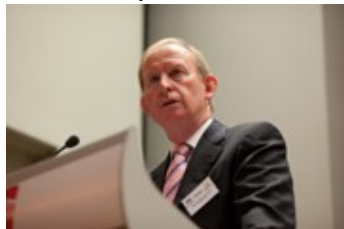
Notwithstanding the relative strength of the Asian region, including the continuing strong growth of China and India, shocks will continue to occur. The region is susceptible to energy

price volatility, disruptions to food supplies and to pandemics. The interdependency between Asia and the US and Europe means that the region will continue to be subject to future global shocks. Achieving a stable US dollar/Yuan relationship remains as a major challenge.

Mr Murray noted that changes now under consideration in the G20 and the Financial Stability Board are highly relevant to global financial stability and therefore to APEC and to the region. He observed that reconciling the different positions within APEC members on some of the issues at the centre of the global financial crisis would be challenging.

Underlying causes of the global financial crisis were excessive leveraging, poor regulation and supervision. Key proposals now before the international community included measures to enhance the capital base of banks and other major financial institutions and constraints on leveraging, improving disclosure and the role of credit rating agencies and constraints on the level and structure of compensation for executives of institutions whose activities could materially impact on systemic risk.

Mr Murray noted that banks would be required to increase capital to cover existing debts and to cover risk through the economic cycle. Additional capital would be needed as banks brought previously off-balance sheet activities onto the balance sheet. These measures would impact on banks' competitive advantages and in particular those with cross-border operations. He observed that there could well be resistance to the implementation of new capital standards. A question to consider is whether the call for increased capital buffers and other measures being proposed for Europe and the US are relevant to Asian economies.



As regards disclosure and the role of credit rating agencies, Mr Murray noted that reliable credit ratings are fundamental to a sound financial system yet there had been a serious break down in the credit rating function. He also noted that prior to the crisis, major banks had observed the requirements of the Sarbanes Oxley act, had conformed with regulatory capital and supervisory requirements and yet a number of major institutions had failed – in a period notable for regulatory over-kill.

He believed that the reason why some had failed and others had survived could be found in the business models employed and in institutional culture. Some models were based on growth at any cost and compensation based on growth related bonuses. The banks that survived had maintained a scientific approach to risk management, pricing risk and the allocation of capital on prudent basis and within solid governance arrangements led by experienced and well motivated boards. He questioned the value of a prescriptive approach to remuneration for bank executives, noting that ultimately, the alignment of a sound business model and culture were at the heart of a successful corporation.

There were challenges ahead in aligning monetary policy and inflation objectives. Asset prices needed to be taken into account in policy measures to stabilize prices.

Improved productivity in the US and Europe is important in redressing global imbalances. For this to occur, investment is needed, including foreign direct investment in key ageing industry sectors in those economies. However, political barriers impeded the flow of new capital, particularly from foreign sources. With strong growth in the Asian region and the region's rising share of global gdp, there are now great opportunities for the region to attract capital. Asian capital markets need to be deepened and reforms to legal systems would be necessary in some economies to facilitate capital flows. Mr Murray noted that APEC is very well placed to respond to these challenges and to promote structural and institutional reforms to realize the great opportunities ahead. Australia is very well placed in the region with a sound and proven regulatory system and with efficient financial markets and deep expertise.



On behalf of the audience of prominent guests from RMIT University, Australian and foreign government officials and representatives from the business and financial community, the Vice Chancellor of RMIT University, Professor Margaret Gardner AO, led a vote of thanks for an outstanding lecture by Mr Murray.