

Maintaining sustainable convergence in a changing world: In Asia

Professor Lamfalussy Conference

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Good Afternoon Ladies and Gentleman,

It is my pleasure and honor to be invited to speak in this important conference sharing the stage with so many distinguished speakers and panelists. I would like to thank our host, the central bank of Hungary for their kind invitation and giving me this opportunity.

Hungary has a special place in my heart and it is always a pleasure to be back. I first visited Budapest nearly 30 years ago when my brother was living here with his family. Unfortunately, my brother passed away 20 years ago in a car accident in this country. He was an organ-donor, so whenever I walk in the streets of Budapest, I always look out for him or at least parts of him.

This afternoon I am asked to speak on the topic of “Maintaining sustainable convergence in a changing world, focusing on Asia and specifically Cambodia”.

First let me start by recollecting some of the changes I see happening in the world. Since the global financial crisis (GFC) in 2008, the world has never been the same. The damage left by the crisis goes beyond financial aspect, reaching far deeper to the fundamentals of our regulatory framework, economic models as well as our society. Regulators were blamed for the lack of oversight on big financial

institutions leading up to the GFC. To make up for the past weaknesses and strengthen the financial system, new rules have been introduced, putting emphasis on the capital strength and governance of banks. This resulted in many global banks withdrawing themselves from some emerging markets or downsizing themselves to reduce regulatory burden. Many economies in the developed world struggle to go back to the level of growth they once experienced pre-crisis. Trust in the banking sector, public institutions, and the media is increasingly lacking. Balancing fake news and freedom of speech become a heated debate.

Globalization, the very basis of economic success of the world so far, is now being challenged. In a recent article by Nobel prize winner Paul Krugman, a strong proponent of free trade, acknowledged some miscalculation in his globalization story, particularly on the local labor market. In Krugman's words "if you have large imports of labor-intensive products, then workers without college degrees are likely to be hurt." Anti-trade rhetoric uprising among those left behind by globalization, betrayed by the notion that a rising sea lift all boats, are common.

In the pursuit of profits and advantage, imbalances and inequities were largely ignored: exponential growth of people who think they will be worse off than their parents, widening disparities between metropolis and regions, educated and uneducated. [A study done by Danny Quah showed that while the average income of the top 10% of the US population has tripled during the last four decades, the poorer half of the population is as poor as they were in 1989 or 1980.] Protectionism has become widespread from the US with President

Trump new economic policies to the UK with Brexit. As societies become polarized, populist rhetoric becomes the norm.

So, what does this mean for a small country like Cambodia?

As part of Association of South East Asian Nations (ASEAN), Cambodia's economy enjoyed significant growth in the past 2 decades averaging around 8%. This growth has been supported by manufacturing, construction and real estate sector and other service sector. The banking sector has also been developing rapidly with credit growing around 25% on average in the past 5 years now reaching 103% of GDP in the second quarter of 2019. With strong macroeconomic indicators, the government projects economic growth to maintain the 7% mark in the medium term. But facing with global uncertainties, maintaining such growth is not easy and requires holistic actions. Financial sector in Cambodia has grown very interconnected domestically and internationally. This wasn't the case 10 years ago. As such, it is now more exposed to external shocks. A shift in policy rate by the Federal Reserve System can affect the liquidity markets in the region and thus in Cambodia. This situation is made worse when 90% of the economy is dollarized. As financial system plays more and more important role in the economy, a slowdown in global economy will also reflect on the balance sheet of our domestic banks through the slowing down of the country's export and tourism. And of course, geopolitics didn't spare some small countries caught in between either.

Although IMF studies showed that countries with low-labor cost and preferential access to US markets could benefit from this trade tension through relocation of manufacturing base, particularly South East

Asian nations, I sometime wonder when it is going to be so and for how long? If this tension continues, US and China economies would inevitably be affected and so would be their domestic consumption. This would mean that we would be worse off in the long run because our survival depends on our trading partners' prosperity.

As if these uncertainties weren't enough, technology disruption is looming. Disruption here of course, could be positive or negative. But for Cambodia as our low skill labor cost increases along with the cost of living, the worries of this category of labor force being replaced by smarter robots is real. Cambodia is one of the main manufacturers and exporters of shoes, but when Adidas SpeedFactory, set up in Germany, can sew custom-made shoes for its customers in a fraction of time of what it would take in Cambodia, disruption becomes real. SpeedFactory not only can manufacture shoes faster with high precision, but can save shipping time, reduce inventory cost etc. (Adidas just announced the closure of the factory in Germany and US last November 2019).

So, to go back to the topic of today conference, how can we maintain sustainable convergence in this changing world? Allow me to answer this in four points.

1/ There is no doubt that Cambodia and many countries in Asia has benefitted by adhering to the current world order, participating in global governing architectures such at the UN, WTO, World bank and IMF that were initiated and led by the West. China accession to WTO in 2001 has uncontestably opened the door to exploit its enormous labor supply and is well on its way to become the biggest economy in the world. A war-torn country like Cambodia, who was subject to

international embargo until 1993 right after it overcame a genocidal regime, has greatly benefited from the WTO membership in 2004, now making it one of the six fastest growing economies in the world, attaining the status of lower middle income country within a period of less than 20 years of reconstruction.

In this regard, it is in the interest of Asia to continue to support and adhere to this liberal international order. Indeed, a globalized world requires international rules to govern; however, in some aspects, local context needs to be incorporated. While implementation of Basel 3 is intended to render financial institutions safer, it is unrealistic to expect banks in Cambodia to do so. In fact, putting Cambodian banks through this regime is counter-productive when regulators have limited skills to validate banks' estimated risk parameter model under the Internal Rule Based approach of Basel 2. While financial integration is ideal to support free trade, prior consideration to domestic financial system resilience and stability must be emphasized.

One-size-fit-all prescription of international rules and standards without consideration to local conditions has a slim chance of achieving the intended objectives. In this regard, convergence should happen only when it results in desirable outcomes.

2/Geopolitics can be a big deterrent to the adherence to international rules and ultimately global peace. Thucydides, an Athenian historian wrote: "it was the rise of Athens and the fear that this inspired in Sparta that made war inevitable." While the big power and the rising power are contesting each other's economy and ideology, small states are caught in between, sometime asking to choose side. Cambodia's

economy is heavily based on its manufacturing export to mainly two destinations: US and EU, consisting of around 60% of its total export thanks for the Every-but-Arms and Generalized System of Preference Scheme. On the other hand, 45% of its foreign direct investment comes from China. For this reason, Cambodia can't afford to choose side. This, as you all know, is easier said than done when the mentality of "if-you-are-not-with-me-then-you-are-against-me" is adopted. [*And when your country's history was once linked with communist regimes, people tend to choose side for you without asking your opinion.*] In this regard, it is important for small economies like Cambodia to not fall in this trap and strengthen its domestic economy's resilience, by diversifying its economic dependence from a few regions to more. For that, Cambodia is fortunate to be a member of Association of South East Asian Nations deemed an economic miracle thanks to its rapid economic growth and increasing importance in the global markets share, poised to become the fourth largest economic block by 2030. Leveraging on its ASEAN membership, Cambodia's market access now expands to ASEAN itself through AEC (ASEAN Economic Community), Japan (through the ASEAN Japan Comprehensive Economic Partnership), Korea, India, Australia and New Zealand through their respective Free Trade Agreements (FTA) with ASEAN.

Here I am not advocating regional protectionism, but instead the diversification of economic partners particularly for small economies like Cambodia. Inter-dependency is good! And when the global value chain is truly global and fairly distributed then perhaps conflicts can be avoided.

3/ The rapid advancement in technology and big data will be a game changer in almost every field, from finance to trade where the boom in cross border E-commerce transactions can redefine existing international trade architecture. In the health care space, new technology has brought cheaper and more efficient medical equipments to the poor around the world who couldn't access it earlier (here I am referring to heart rate monitor replaced by your Apple or Samsung watch, or blood sugar test done over a mobile application) and in art (if 3D printing of a drawing is considered an art, then sculpturing has a big competitor coming on its way!).

Technology not only allows rapid transfer of knowledge, but also for developing economies to leapfrog stages of development. India's economic model for instance didn't follow the traditional path of China or the four Asian Tigers. Instead, it jumped straight from agriculture economy to service economy. In an era of digital economy, industrial infrastructure (such as roads bridges labor law investment law etc.) is no longer relevant. Asian start-up scene is becoming increasingly vibrant not only because the regulations are favorable but also in some instances thanks to the lack of ones. Chinese online shopping platform Alibaba, Singapore's ride hailing Grab, Indian marketing platform Immobi are taking on the world.

In Cambodia, while the state of our roads and bridges are an envy to no one, our data coverage (both in speed, coverage and cost) should be. For roaming to 15 countries in Europe Hungary included, cost me 5 USD a day for unlimited data usage. Within ASEAN, it would cost me 1 USD. Thanks to this coverage, mobile phone penetration in Cambodia reached 20 million mobile subscription for a population of 16 million. Financial Inclusion was partly rendered possible thanks to

this infrastructure. Last July, the National Bank of Cambodia becomes the first central bank in the world to use blockchain technology for its backbone payment system: the Bakong Project. This system would allow peer-to-peer money transfer between banks' customers domestically, but hopefully soon, internationally facilitating remittances from our migrant workers. However, what make me more exciting about cashless economy is not just the convenience and efficiency, but also its implication on the governance and transparency of our economy. As Cambodia is moving from a low-income country to a low middle country, its access to aids and concessional lending from donors and multilateral organizations has become more limited. As such, the country has now to depend on its tax collection. Many reforms have been put in place to improve tax collection: one being tax payment through electronic payment platforms thus eliminating unofficial leakages. For the past 3 years, Cambodia tax revenue collection increased by 30% y-o-y.

As the world become more and more uncertain it is important for Asian economies to strengthen its domestic macro fundamentals resilience by strengthening its institutional governance, transparency and education system. Technology, if embraced early enough, can be an efficient tool to do that and bring the region to the next stage.

4/ Climate change related natural disasters are a common scene in the media: Australia's bush fire, Jakarta's flooding, Manila's typhoon and recently volcano eruption, are just some of the news we have seen this year before the first month even ends. 97% of scientists, including 72

Nobel Laureates winners, agree that global warming is happening and that we are the cause. Models show there are unprecedented levels of CO₂ in the atmosphere coinciding with fossil fuel use and that climate change is caused by CO₂'s and other greenhouse gases' trapping radiation and causing global warming. The IPCC, the UN body responsible for climate research, has outlined 1.5C as the critical temperature. Warming above this level increases the risk of irreversible change and the potential point of no return. To keep emissions below this, greenhouse gases need to be halved by 2030 and reach 'net-zero' level by around 2050. Reaching this requires serious reduction in our carbon footprint and fossil fuel use, as well as the embracement of clean renewable energy sources. "Winter is Coming" is a famous line from the famous drama series Games of Throne, where different power houses are calling for Truce to address a common enemy. "Global Warming is Coming" and demand global action. Climate change not only brings about economic uncertainties but also the uncertainties of our human existence.

World bank database shows that Cambodia's per capita CO₂ emission is 0.4 ton in 2014, while United States per capita annual CO₂ emission 16.5 ton that same year, 40 times more. Cambodia joined the Paris Climate Agreement and is now working with all stakeholders to meet its commitment. In 2016, the Association of Banks in Cambodia officially joined the Sustainable Banking Network, an initiative of the IFC, committing to sustainable financing. Last year, the National Bank of Cambodia, Ministry of Environment and the Association signed a partnership over a two-year period to develop Cambodian Sustainable Finance Initiative (CSFI).

No country is spare when natural calamities come and most often than not, it is the small developing countries who has limited resources to protect themselves that are the most affected. Emerging Asian economies, and beyond, could lead the way in tackling climate change, like Arya Stark tackling the Night King. Bhutan is a real-life great example and a source of inspiration for many, on compromising economic growth and environment preservation at the same time as people happiness.

Ladies and gentlemen,

The world as we've seen it today is angry. And those anger are sometimes expressed in irrational ways. But anger is tiring and I am confident that with time it will fade. In the meantime, as policymakers, we should be mindful, sensible when implementing new policies (all policies are based on the assumption that people act in a rational way, but when they are not, policies can have unintended results). Asia can learn from the West that even well-intended, supposedly well-designed policies, can be a trigger for social unrest.

For Asia, maintaining sustainable convergence needs to be done in a strategic manner. Such actions require foresighted and holistic policy making that goes beyond economic models, but also taking into account geopolitical, technological and climate change implications.

Thank you for your attention!

