Global Conflict over Exchange Rates, Part Two

Joseph E. Gagnon and John Williamson explain why China and other developing countries in Asia and Latin America feel the need to accumulate reserves and whether their actions are justified.

Transcript of interview recorded August 20, 2012. © Peterson Institute for International Economics.

Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics with Joseph Gagnon and John Williamson in the second part of our discussion on exchange rates. John Williamson, you just said that these countries, particularly in Asia, who are manipulating their exchange rates or accumulating reserves, that the West is at least partly to blame for their actions. What did you mean by that?

John Williamson: I meant that in the time of the Asian crisis in 1997, instead of coming to the aid of the countries, or when they came to the aid of the countries, they imposed very tough conditions on them and they humiliated the countries. It was felt very deeply in Asia that there was quite a deliberate act of humiliation there, that in talking about the need to get over crony capitalism. These countries had been growing extremely rapidly and extremely impressively and they've gone on growing, though less rapidly, since the crisis because they put some of their resources in for balances and payments instead of into an investment.

Steve Weisman: Joe Gagnon, everybody has a reason for doing things. People act irrationally. What difference does it make?

Joseph Gagnon: I think it's important that we think about what is a reasonable level of reserves for insuring against the kind of shocks that people were worried about during the Asian financial crisis. I would say two things. I agree with John in terms of how Asians perceived they were dealt with during the Asian crisis and I think there's some truth to it, too. I do think it could be exaggerated, but there was some real truth to it. Out of this feeling of grievance, they have felt that they wanted to build up war chests of foreign assets to defend themselves against attacks. But I think people who have studied this have said they long ago achieved war chests that were bigger than they needed to shield against any conceivable future crisis. Maybe five years ago, they achieved that point. They've gone past that.

But the other thing is, they may have taken on the wrong lesson, because I think the thing that they have done that has better insulated them from the crisis than building reserves has been to improve their financial

supervision and regulation, and especially to reduce their reliance on borrowing in foreign currencies, which was a real Achilles' heel for them during the crisis. They have changed and that means that they will be less vulnerable, regardless.

Steve Weisman: And I suppose the crisis of the last few years demonstrates the success of that strategy.

Joseph Gagnon: Absolutely. They say it demonstrates that their reserve holdings helped them. I think that's a misinterpretation of what happened. I think, in fact, it demonstrates that the other thing they did, which was the reduction of foreign currency borrowing, helped them.

Steve Weisman: John Williamson?

John Williamson: One can think that both of these things helped them.

Steve Weisman: It's over determined.

John Williamson: Yes.

Steve Weisman: John, what about the argument that they've just gone overboard?

John Williamson: This is a view to which I subscribed five or six years ago, that they've built up war chests quite enough. But the fact is that coming through the crisis, this latest crisis, countries which had built up their reserves even more, felt that they benefited by those extra reserves. The Koreans felt that they hadn't built up their reserves enough. I mean, I thought that they had built them up quite enough and they didn't, in fact, run them down as far as, in my view, they could have done. But this view is strongly held that there is a great benefit in building up reserves. Given that that view has held, I think we at the very least all have an obligation to do something to try and provide them with an alternative type of insurance.

Steve Weisman: OK. I want to move to Part Three of this interview. Thank you.