

# **The Emergence of China and India: Implications for the Regional and International Financial Systems\***

**Bandid Nijathaworn  
Bank of Thailand**

Let me begin first by thanking the organizers, especially the IMF, for inviting me to speak today. It is a pleasure to be here.

This session looks at the implications of the growth of China and India for the regional as well as international financial systems. On this issue, in the last two days, previous speakers have made important observations about the changes that are taking place in the financial markets of both India and China. At the risk of overlapping, I want to add to the discussion by making just three points, but in a much broader context.

The first is about the opportunities and challenges for the region's financial markets that will come with the continued growth of China and India. The second is to share my thoughts on how we should go about

---

\* Remarks made at a panel discussion at a conference on "China's and India's changing economic structures: Domestic and regional implications" organized by the IMF, Kerry Centre Shangri-La Hotel, Beijing, October 27-28, 2005.

meeting the challenge. And the third is the implications in a wider context for the international financial systems.

In recent years, many aspects of what a continued rapid growth of China and India would mean for the world economy have been researched and discussed. The consensus that emerges is that the rapid growth of both economies will continue, and the continued growth will impart immense benefits to Asia and to the global economy. The benefits will be far-ranging; the major ones will include continued expansion of global demand for goods and services, increases in intra-regional trade and investment especially within Asia, and a substantial further reduction in poverty in the two economies. But, to me, the most important benefit will be a more durable global economic structure brought on by the narrowing of income disparities, and by the general rise in the world's living standards.

On this issue of growth, I am inclined to believe that continued rapid growth of China and India will provide the global economy with an important impetus for many years to come. And with it, Asia can return to the old order, transforming itself into a major center for growth and financial activities in the global economy.

In this process of change, opportunities will abound. So far as the region's financial markets are concerned, key benefits will largely come from the change in the pattern of consumption of the world's two most populous economies as their per capita incomes go up.

Higher per capita incomes will inevitably lead to a more sophisticated demand behavior, of which a key part will be an increase in the demand for financial services in both economies, to support the growth in consumption, savings and investment. And as the economies of China and India become more monetized, this expansion in demand for financial services will offer immense opportunities for the financial services industry worldwide.

Such opportunities, as I see it, will come in three key areas.

The first is the provision of the basic banking services to a mass-consumer market. The second is opportunities in the mobilization and management of savings given the traditionally high saving rates of the two economies. And the third is the intermediation of funds, from savings to investment, which will mean greater opportunities to facilitate the flows of savings to finance investment. This financing will not be limited to the investment growth in China and India, but the whole of the Asian region will also benefit.

Obviously, the region's financial industry is well aware of the opportunities, and some have already benefitted from this development. But to effectively capitalize on this positive trend for the benefits of the Asian region, I think one should strive to further develop and integrate the region's financial markets so that efficiency gains in the use of the region's financial resources can be maximized. On this note, while efforts on trade integration have moved rapidly through a number of bilateral and multilateral trade initiatives, similar efforts on regional financial integration are only beginning.

At this time, progress that has been made to better integrate the regional financial markets includes the launching of the Asian Bond project and the capital markets development projects. But relative the economic and financial potentials of the region, I think much more can definitely be done. Among other things, the integration will help recycle the region's saving surpluses so that they can be more efficiently utilized within the Asian region.

The opportunities will also mean a further strengthening of the financial markets, institutions, and infrastructure in both China and India to meet the growing demand for financial services. With this development, there will be more business opportunities for Asian financial institutions in these two markets once they become more open.

But to be able to successfully compete with other international players, Asian financial institutions will have to make substantial adjustments. For example, a large number of international banks have already made adjustments to reduce costs through the outsourcing of back-office works, research, and accounting, some of which go to China and India. The adjustment will also mean the need to move up the quality ladder to be able to offer financial services of international standards at competitive prices. This will be a huge and important challenge for our Asian financial institutions.

But at a deeper level, as the economies of China and India expand, what we will be seeing is not just rapid growth, but an important phenomenon involving two major strands of transformation taking place at the same time. The first is the development transformation in which the two most populous economies in the world move up the ladder of development. And the second is the extension of the process of globalization to encompass even a larger segment of the world's population. An important question to think about, therefore, is how best to ensure that this process of transformation continues in an orderly manner, and that it is sustained.

From a financial markets perspective, a key threat to an orderly transformation is the risk of a boom-bust type of economic cycle, which,

if happens, can disrupt or even set back the progress that has been made. In the context of globalized financial flows, the risk of disorderly transformation will be closely linked to the volatility of international capital flows, especially when the economies of China and India become more open. Managing the risk of volatile capital flows, therefore, will be an important and the most delicate policy agenda going forward. Success in managing this risk will go a long way in ensuring a sustained process of transformation. Conversely, a failure to adequately manage the risk could jeopardize the current process, with possible adverse consequences to the regional economies.

Ten years ago, the economies of South-East Asia - so called “the Asian tigers” - also faced the very same challenge. Then, the scale and the intensity of the financial flows were much smaller and were less complex than what we are seeing today. From that experience, it becomes clear that the risk from volatile capital flows can be detrimental to the economy and to the financial sector, and such risk must be adequately managed. In doing so, careful attention should be given to three issues.

First is the process of capital account liberalization. Most important in this context is the pace of liberalization which should be carefully worked out so that the domestic economies will not be overwhelmed by large and persistent capital flows. Also, the flows in

terms of reversibility and duration should be consistent with the abilities of the domestic financial institutions to manage the risk effectively.

Second is economic flexibility. This is important because greater flexibility in terms of economic structure and policy regime will be crucial in increasing the abilities of the economies to deal with the vagaries of the force of globalization. Important in this context is the flexibility of domestic prices which is linked closely to the roles of market and competition. In my view, greater flexibility will go a long way in helping the domestic economies to cope better with the force of globalization.

And third is sound policies especially with regard to macroeconomic policies and structural reforms. On this issue, I think it is of considerable importance for the whole Asian region to have a stronger and more resilient financial sector. At this time, the region's growth prospects are bright and this is relatively a very strong positive feature for the region. But, to me, our weaknesses, if any, remain in the financial sector. Therefore, to ensure a sustained expansion, we need to do more to close the gap. And in the context of China and India, a more resilient financial sector will go a long way in helping to strengthen the current process of transformation.

All of what I have said are not new. But I am raising them again because they are the important policy points which will have profound influence on the outlook of the region.

My last point is on the implications for the international financial system in a wider context.

On this, I have only one point to make. That is, one of the key long-term outcomes of the current process of transformation will be a redistribution of claims over the world's financial and economic resources, made possible by a major change in the relative prices as a result of globalization. And with this change, the financial prowess of China and India in the international financial system will also grow, leading to a debate over the issues such as roles and responsibilities, as well as voice and representation.

While these developments are important, the point I want to make is that the new wealth will also allow the two economies to spend and consume more of the world's resources. And as the demand for world's resources increases, the process of transformation will be sustained only if the global economy utilizes the available world resources efficiently.

At present, inefficient use of certain commodities such as oil has created externalities to other economies in terms of the high oil prices. To sustain the current process of development that we are now seeing, it is important that we promote greater roles of markets in allocating scarce resources, especially at the level of individual economies. This is important because world resources are limited. And the use of resources that are properly priced will go a long way in making the transformation process much more sustainable.