금융감독원 FINANCIAL SUPERVISORY SERVICE

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The Role of Finance in a Creative Economy

Ladies and gentlemen,

It is my great pleasure to speak at the Bellwether Series on Korea. I want to begin with my thanks to Simon Cox, Asia Economics Editor for the Economist, and Charles Goddard, Asia-Pacific Editorial Director for the Economist Intelligence Unit, for inviting me to speak at today's conference.

As you know the Bellwether Series is organized by the Economist. I need not tell you that the Economist covers economic and political affairs around the world with great authority and a tradition of excellence. So I am especially pleased to speak to you today on changes unfolding and the way forward for Korea's financial industry. It is my hope that today's conference gives us a chance for some fresh thinking on revitalizing our markets and economy.

The market conditions and outlook for the financial industry are different this time from those that prevailed during the 2008 global financial crisis in many important ways. Let me highlight four that I think are particularly relevant to our discussion today. They are slow global growth, evolving global liquidity conditions, globalization of financial regulation, and evolving industrial structure.

The first is sluggish global growth. This time, it is not just the developed economies that are experiencing sluggish growth. We now see growth slowing in China and other emerging economies as well. Some are already calling this a "New Normal" for the global economy.

In July, the Economist called it the "Great Deceleration" for the emerging economies. So the prediction is that the global economy will prove difficult for both the developed and the emerging economies. Such predictions obviously raise some difficult questions about the future for the financial industry.

In addition to slow growth, we must think about the likely shift in global liquidity conditions. As the debate on U.S. Fed's tapering heats up, many emerging economies are becoming uneasy about the prospect of large capital outflows. Such concerns have been more limited in Korea on the strength of its substantial current account surplus and ample foreign exchange reserves. I would also point out Korea's fiscal prudence and low short-term debt ratio.

Soon or later, however, we are likely to see significantly reduced liquidity and major shift in global capital flows. For the financial industry, the new landscape will pose fresh challenges as well as opportunities.

The third difference I would note is the globalization of financial regulation. We see financial regulations getting tougher and cross-border cooperation getting stronger worldwide. As you know, global regulatory reform has been in the works for some time under the leadership of the G-20. In particular, regulations on systemically important banks, large exposures, and central counterparty clearing are already on the table. Global discussions on issues ranging from OTC derivatives risk to shadow banking to accounting standards are ongoing as well.

The globalization of financial regulations, however, can pose fresh challenges, especially for Korea and others whose financial markets have not yet reached the developed stage. One challenge is how to ensure consistency between individual market reality and global regulation. The risk is that regulations may get more complex and further hold back financial firms than before.

The fourth difference is what I would call the evolution of industrial structure. I think we have to pay attention to structural changes taking place across industries around high value-added goods and services. In the past, it was mostly the level of labor and capital inputs that determined economic growth. Now, innovation and creativity have become the key drivers to success. The smart phones are a wonderful example of creativity that generates enormous value and forever changed the way we live. It is also a time of transition for the financial industry as the real economy evolves yet again.

In short, the global economy can no longer count on high growth of the emerging economies. This suggests that the growth models of the past may well have reached their limit. And uncertainty continues to grow and loom large over financial markets, and regulation will only get tougher. So the time has come for us to ask the question: What will the growth equation look like for Korea's financial industry and economy?

For answers to the question I just posed, I think it's instructive to turn to the United Kingdom and Israel. I cite these two countries because they are taking advantage of their unique strength to promote creative industries. They also have had great success with improving their industrial structures, which helped them restore growth.

The new administration took cue from these countries and put forth "creative economy" as the prime national agenda. The goal is to create new markets and new jobs by fusing together one industry with another and blending industries with ideas unique to our culture. The foundation for this is science and technology, especially information and communication technologies.

With a focus on creative businesses and individuals, a creative economy generates new industries from the old. It cultivates an ecosystem that helps to turn a creative industry into the newest industry leader. And it brings together large and small businesses, and helps them reinforce each other's strength and compete globally.

I would argue that the success of the creative economy we envision depends, to a significant extent, on the financial industry. I say this because, no matter how creative an idea may be, the transformation into a viable business requires a partner in finance. That is, there can be no creative economy without creative finance. Imagine what could have happened if Thomas Edison could not raise capital for his electric light, a truly creative idea for the humanity, more than a century ago. Perhaps we wouldn't have a global giant we now know as General Electric. So we cannot over-emphasize the importance of finance in turning a creative idea into a business and an industry.

There is no question that Korea's financial industry has played a major role in the nation's industrial and economic advancement. That is, the financial industry provided critical support to industrial development by pooling together scarce capital.

But the industry's landscape has changed drastically over the years with aging population, low growth, and low interest rates. And the new landscape demands a new paradigm that is no longer tied to the past. For example, financial firms must now consider more aggressive overseas expansion to improve their growth potential. As businesses seek deleveraging and more internally driven growth, financial firms will need to respond to the shifting demand. Financial firms must also respond to higher investor and consumer protection expectations and help restore trust in the market.

One question we must ask in all this is whether our financial ecosystem can keep up with changes taking place in the marketplace and in the business ecosystem. We must also ask whether the pace of innovation in the financial industry is enough to support the creative activities of individuals and businesses.

Let me now put forth some ideas on how the financial industry can contribute to the creative economy we are aiming for. There are four I would like to present to you. They are investment-centric funding and technology valuation, market revitalization through regulatory reform, corporate restructuring, and new value creation from overseas markets.

First, I see a need for more investment-centric funding, which is more suitable for the high-risk, high-return nature of start-up companies. Currently, nearly 99% of start-up and SME funding takes place in the form of loans. Clearly, this is not an investment-driven funding, and it should give us a pause.

This is because even businesses with the most promising technology and creative ideas cannot succeed without direct access to capital. For this reason, it was encouraging to see new provisions on investment banking for promising business start-ups in the newly amended Capital Markets Act that took effect in April this year. The financial industry must also improve the infrastructure and level of expertise needed for consistent and reliable valuation of creative technologies and their business potential.

This means that loan application screening and credit rating should be conducted with not only financial perspectives, but also technology and long-term viability perspectives. Going forward, corporate finance will need to do a better job of assessing the core competence of businesses and picking winners.

Second, we need to inject fresh vitality to the ecosystem for the financial markets and the creative economy with regulatory reform. As we all know, ineffective regulation hinders efficient capital allocation and utilization by diminishing the market's innovative and creative powers. The end result is higher market transaction cost and inefficiency.

So we will continue to focus on raising our financial regulation and supervision to global standards. To this end, we believe regulations that are necessary should be reinforced, and regulations that are excessive should be trimmed to the right level. This will help renew dynamism in the market and raise the financial industry's competitiveness to the next level. Some point out that our financial regulation and supervision could be improved with greater transparency and consistency. We understand it, and we are going to work hard to address it.

Third, we intend to encourage more active financial intermediation with effective restructuring of companies in financial difficulties. As I am sure you agree, our scarce capital should be channeled to productive, high value-adding companies. And, to do this, the market must be able to separate the good from the bad.

It is said that 99% of companies in Korea are small or medium-sized enterprises (SMEs). So, in the course of restructuring, we are going to pay attention to credit flow to SMEs, especially to strong, innovative companies.

In creating a supportive environment for SMEs, we understand the need for effective, meaningful assistance. So we are meeting with them and listening to their needs on a regular basis. In fact, in April this year, we selected ten SME financial support tasks and formed a task force to carry them out.

I also see a need for a system that gives a second chance to companies that suffer from honest or unavoidable failure. To this end, we will make sure loan officers are not unfairly blamed for SME loans that turn sour even with the best and honest intentions. From a long-term perspective, we should see growing entrepreneurship with many second chances under expanding safety net. This will also facilitate the creation of venture capital in the capital markets.

We will also be looking to implement wide-ranging measures designed to help companies thrive and prosper. If we can help great small companies get a second chance, their employees' income will rise, more jobs will be created, household debt will fall, and the economy's potential growth will expand.

Lastly, I believe the financial industry needs to look more aggressively to overseas markets for new value creation opportunities. As you know, many domestic financial firms find the home markets too saturated for new growth opportunities.

The diminished ability of financial firms to generate strong earnings can turn into a major obstacle to the creative economy we seek. That is, without the ability to generate sustainable growth, the financial industry cannot accommodate risk-taking needed to achieve creative finance.

So the challenge is to secure diversified earnings overseas and aim for more stable business structure. Indeed, this will be critical to the future success of the financial industry and creative finance. Therefore, financial firms must take a fresh look at past failures, take the best possible preparations, and aim for success in overseas markets.

Many attribute the recent emerging market distress to uncertainty over the direction of U.S. monetary policy. The more likely reason, however, is weaknesses in the economic fundamentals of the emerging economies. Therefore, the emphasis should be on bringing about structural improvement. Now, the challenge for Korea is to actively promote the growth of the service sector, diversify exports, and continue to advance financial markets. We will also need to work hard to improve corporate and social governance.

This is a time of major change in global economic and financial paradigm. Today's conference will help us bring together many fresh and creative ideas for a constructive debate on challenges ahead for our financial industry and economy. It's a special occasion, and I once again thank the Economist for organizing such a valuable conference.

Thank you.