

ADF DISPATCHES

East Asia: The Unfinished Agenda

Wednesday, March 11

Public Disclosure Authorized

Public Disclosure Authorized

Public Disclosure Authorized



DON'T REVERSE GLOBALIZATION, EXPERTS SAY, JUST WATCH THE RISKS

Globalization—the term used to describe today’s increasingly open and interlinked markets—shouldn’t be reversed in response to the financial crisis gripping Asia currently.

That was the consensus among economists and analysts addressing the ADF Tuesday. However, all agreed that the crisis has dramatically brought home the fact that globally linked, liberalized financial markets can be perilous if the necessary regulatory and institutional frameworks aren’t in place. “Globalization is a double-edged sword,” warned Peter Sullivan of the Asian Development Bank. “It rewards good policies but punishes weak policies and institutions.”

Robert Lawrence of Harvard University’s Kennedy School, noted the outbreak of “globophobia” in the West — a recently coined term describing some U.S. fears that notwithstanding record employment levels in the country, the global economy hurts American companies and workers. He said he doubted the trend would become dominant in the U.S. and assured Asian participants that the U.S. would continue to be a major market for Asian goods.

Rather than retreat from the global economy, Asian nations should develop better strategies for managing risks inherent in an interlinked financial system, according to Chalongphon Sussangkarn, president of the Thailand Development Research Institute. Because the government had pegged the currency to the U.S. dollar at a fixed rate, business ignored the exchange rate risk and borrowed heavily in U.S. dollars. The expectation that governments would protect private firms from bankruptcy similarly removed needed discipline from the system, he said. □

QUOTE OF THE DAY

“Capitalism is like democracy. It has lots of faults, but it is better than the alternatives.”

–Mitsuhiro Fukao, Keio University.

REGIONAL TIES CALLED PRIORITY FOR ASIA

Regional economic integration should be a top priority as Asian countries navigate their way out of the current financial crisis, according to experts participating in ADF discussions Tuesday. They stressed the importance of opening up trade and investment opportunities within the region, a move many saw as

(continued on page 2)

HABITO SEES ASIAN CRISIS AS 'PROBLEM OF PEOPLE'

Cielito Habito, secretary of Socio-Economic Planning at the Philippines' National Economic and Development Authority, urged ADF participants to view the Asian financial crisis not just in economic terms but as "a problem of people, of human lives and families' well being."

Looking at the cost the crisis is exacting, he pointed to a string of hardships:

—On jobs: the Philippine government alone has received notices of layoffs or retrenchments affecting more than 19,000 jobs, and unrecorded cases could double the figure.

—On prices: inflation rates are rising after the devaluations, with to 8.9% in Thailand to 32% in Indonesia.

—Budget cuts: spending constraints will affect health budgets, subject to increases of 40% in the costs of pharmaceuticals and rugs.

—Education cuts: budget pressures will hit schools, teacher training, and special education programs. According to anecdotal evidence, students are dropping out because of breadwinner parents losing a job.

Mr. Habito also cited a number of environmental problems that stand to worsen as a result of the crisis. There will be more pressure to chop local forests to generate export earnings. Laid-off workers will turn to fishing for a livelihood, adding to overfishing pressures in coastal waters. Anti-pollution equipment is becoming more expensive to import.

Mr. Habito said that solutions to both the social and the environmental strains will demand involvement outside government. He called for "a creed of caring" where those who might benefit from the turmoil— certain exporters and expatriates, for example— work "to alleviate the plight of the losers." □

Asia's Environmental Bill is Coming Due

"Asia has one of the most degraded and polluted environments on the globe, and it is continuing to deteriorate fast. The teeming and often uncontrolled growth of urban areas as well as the mismanagement of rural and marine resources have all played their part in Asia's environmental decay. Further environmental neglect will not only seriously impair the quality of life in Asia, it will risk slowing economic growth. No longer can Asia afford to pollute now and clean up later."

Andrew P. Sullivan, Vice-President, Asian Development Bank.

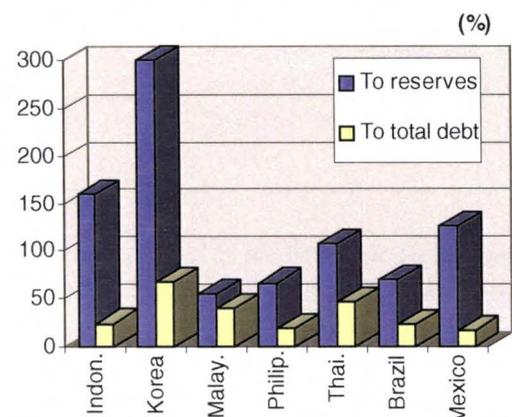
REGIONAL TIES, *continued from page 1*

more important than pushing an export strategy aimed at countries outside the region.

Robert Lawrence, of Harvard University's Kennedy School, urged Asian nations to declare immediately a hold on any new trade barriers within the region, and to agree to a zero-tariff levels within ASEAN countries. He warned that Asian nations should compete for foreign investment on the basis of fundamentals, not through subsidies and tax breaks.

These sentiments were echoed by Ponciano Intal, president of the Philippines Institute for Development Studies, who argued against "the centrality of exports as a development strategy." He said the future "lies in deepening further the integration in the region and with the rest of the world." He added that for the region to pick up economically, "we will need a more robust and open Japan." □

Short-Term Debt Ratios



INTERVIEW: Ronald I. McKinnon

EDI interviewed Ronald McKinnon, a Professor of Economics at Stanford University, on February 27, on the issues surrounding the Asian financial crisis.

Q: *What is your view of the Asian crisis?*

Prof. McKinnon: There are two crises in Asia: the longstanding slump in Japan and the current twin crises (of banking and currency) in other small Asian countries. These two crises have been somewhat mutually reinforcing though their origins are different.

The slump in Japan affected this crisis mainly in the sense that its economy remains very weak. Also, I think, Japan's world-lowest interest rates compounded the moral hazard problem in the other Asian countries, contributing to their excessive borrowing.

Q: *Let's focus on the financial crisis in "small" Asian countries. What are its main causes?*

Prof. McKinnon: This crisis is different from the Latin American crisis in that there wasn't a clear case of macro-mismanagement. So, we have to look for another explanation, that is, the moral hazard problem in Asian financial institutions. People in these countries took the view that the government would come to rescue banks and, thus, their deposits were safe. This is like a blanket deposit insurance. This means that there was potential moral hazard with bank management because they could undertake risky lending strategies.

And I think this premature liberalization of the capital market which enabled the banks to take very risky forms of finance, that is, financing in dollars and yen rather than domestic currency, compounded the riskiness.

However, the precise trigger of the crisis was just an accident. Political breakdown in Thailand exposed bad loan problems and speculators began to look around other Asian countries.

Q: *Asians are increasingly skeptical of financial liberalization because of this crisis. Liberalizers are in crisis while China is not. What is your analysis?*

Prof. McKinnon: China has not liberalized its capital account, thus, it was much less vulnerable. Chinese banks

have not built up short term foreign currency debts. Even through China also has a banking crisis with bad loans, its quite strict controls on the capital account prevented that from becoming a currency crisis.

Financial liberalization is still the right way to go because the economy is not going to grow satisfactorily without it. But, there is an order of financial liberalization. There are number of things to be done before you risk opening the capital account.

Q: *Asian currency values collapsed during this crisis. Which would be the best exchange rate system for these Asian countries in crisis?*

Prof. McKinnon: I'm an unusual economist in that I think the exchange rate systems were more or less correct before the crisis. These countries, to some degree, all pegged to the dollar and formed a zone of monetary stability among themselves. But you need much more stringent regulation on risk-taking by insured financial intermediaries.

Q: *Do you see any structural problems in the international financial system?*

Prof. McKinnon: Moral hazard is a two-sided problem. Countries receiving foreign capital are too eager to borrow and big international banks engage in overlending. They are, in fact, also insured by their national governments. There is a doctrine in money and banking called "too big to fail."

The further issue is compounded by having volatile exchange rates among the big industrial countries. The swings of the yen and dollar exchange rate make it difficult for small countries to set their exchange rates correctly. What we need is more exchange rate stability in the world system.

Q: *What is the proper role of multilateral institutions in solving this crisis?*

Prof. McKinnon: The IMF has done better than most people think it has done in this crisis. But the limitation on the IMF is that it must deal with each country -- one on one. In a regional crisis with contagion, what you need is regional stabilization fund which takes positions in different currencies, mostly undervalued, and attempts to prevent their multiple devaluations. □

MEDIA EXAMINES ITS ROLE IN CRISIS AND RECOVERY

Asian journalists explored the crucial role that the media played in the on-going financial crisis in Asia and discussed ways that they might cover economic problems and solutions in the future. Meeting in a workshop entitled "Economic Journalism in a Changing World," journalists from Philippines, Vietnam, China, Laos, Indonesia, Papua New Guinea, Cambodia and Thailand examined journalistic practices across Asia and some of the lessons that had been learned during the financial and economic turmoil of recent months.

Among the topics discussed during the first day of the workshop were whether government or self-imposed censorship had prevented a frank and open discussion of the issues and whether so-called "crony capitalism" was matched by an equally harmful "crony journalism".

While journalists in some countries such as Thailand and the Philippines had very early begun exposing some of the hurtful practices in banking and financial management that contributed to the crisis, other journalists said they were caught unawares.

Other practices such as deeply-held traditions of doing business through networks of friends and family still are ingrained. The attitude about such practices, one Malaysian journalist said, is "why criticize something that works?" But in the end, the crisis may effect not only the ways Asia does business, but also the ways journalists write about this important subject for development. □

Acknowledgements

In hosting this meeting of the first Asia Development Forum, the World Bank and the Asian Development Bank greatly benefited from the assistance of the National Economic and Development Authority of the Government of the Philippines and from the Philippines Institute of Development Studies.

VIEWS FROM ADF PARTICIPANTS

□ *What do we keep and what do we change?*

"We shall keep the solid macroeconomic fundamentals and reform microeconomic practices."

Manuel Montes, Senior Fellow, Institute of Southeast Asian Studies, Singapore

"The high savings rate, abundant human capital and ability to export should be maintained. In the short run, there is the need to regain credibility and confidence in the economy."

Fukumari Kimura, Associate Professor of Economics, Keio University

"The low inflation registered during the decades of economic growth is the main element of the success. What needs to be done is to break up the inefficient way of interaction between the government, and corporate and financial sectors."

Nora Lustig, Brookings Institution, U.S.A.

"The flow of foreign capital and the opening of the markets have been the key elements (of East Asian miracle). What needs to be changed is the high import-dependence."

Imam Ahmed, Indonesia

"The government's protection of strategic industries contributed to the rapid industrialization, but, now, that needs to be changed because too much protection of domestic industries can undermine competitiveness of the countries."

Jun Tian, Deputy Director General, State Planning Commission, China

"Substantial investments on health and education significantly contributed to economic success in the region. Now, skills to meet new demands."

Anita Viitanen, manager, Social Development, Asian Development Bank