

ADF DISPATCHES

East Asia: The Unfinished Agenda

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EAST ASIA: THE UNFINISHED AGENDA

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STIGLITZ CALLS FOR MORE CAUTION AND SUPERVISION IN FINANCIAL SECTOR

World Bank chief economist Joseph Stiglitz argued against “mindless liberalization” of the financial sector, and called instead for a carefully sequenced opening of the banking and financial businesses, with an emphasis on monitoring and supervision.

In the keynote address at the ADF, where economists and policymakers have been exploring the painful economic reversals in East Asia, Mr. Stiglitz took the position that “across-the-board deregulation of financial markets” isn’t justified by either economic theory or experience. Underscoring the need to guard the financial system, he reasoned that banks and financial houses function as the “brain” of an economy, collecting savings and allocating them to the most productive recipients.

He urged policymakers throughout the world to “understand the role that government plays” in sustaining financial systems that can support equitable growth. Specifically, he said that governments have a responsibility to:

- improve supervision of financial institutions, including the promulgation of risk-based capital-adequacy standards.
- remove incentives that lead to excessive reliance on short-term capital flows.
- limit exposure to real estate and foreign exchange.
- monitor lending in the corporate sector.

Discussing the various imperfections of the financial markets—and the reasons for not relying solely on market forces— Mr. Stiglitz emphasized the frequent lack of information. In the case of the East Asian economies, lenders saw mostly reassuring data on the macroeconomic conditions. However, it was private sector debt problems that created the vulnerabilities, he noted, adding that “getting information about private sector spending and borrowing is much more difficult.”

Mr. Stiglitz closed with a broadly hopeful message for the region. “It’s hard to imagine the recent turmoil undoing the gains of the past half century,” he said. “Several factors bode well: these economies are export-oriented; they have lots of flexibility and adaptability; reforms are comprehensive; and most governments are reacting fast. Nowhere else has there been this kind of resoluteness.” □

QUOTE OF THE DAY

“The elements that led to an unraveling of this success must be confronted honestly. In the face of relentless globalization, these elements are all the more glaring: lack of proper regulation, transparency, and accountability that are vital in a highly integrated global economy.”

---- Vinod Thomas, Director, Economic Development Institute, World Bank

Thinking about rethinking the Asian miracle was a topic that drew a capacity crowd yesterday. Harvard's Robert Lawrence remarked, "One of the unfortunate contributions that the World Bank made was labeling the Asia economic growth a miracle." Meredith Woo-Cumings of Northwestern University lamented the tendency to "read history backwards" turning Korea's development success into "a cesspool of crony capitalism" in discussions of the recent financial crisis. Prof. Lawrence drew attention to Asia's ability to continue growing after 1973, when other parts of the world slid into stagnation and high inflation. "If that resilience can be replicated" today, he added, the future may be much brighter than the current gloom would suggest.

Foisting fiscal medicine on the wrong patients is a frequent charge leveled against the IMF by Asian economists. For his part, the World Bank's Mr. Stiglitz recalled debates in the White House, where he was economic adviser, over a proposed constitutional amendment requiring a balanced budget. One of the main bases for fighting the plan was that it would force fiscal austerity on the country during economic slumps, thereby making the bad times worse. Why is this being prescribed for the depressed Asian economies? "The standard view is that it's important to restore a flow of funds to countries," he said, adding that many believe the fiscal discipline will bring back the investment flows, and shore up exchange rates. But he added that the resumed flow of external investment could be offset if "people move the stock of their wealth out."

Muddling through the Indonesian malaise is the likely result of the current policy impasse in that economically stricken country, according to Mari Pangestu, executive director for the Centre for Strategic and International Studies in Jakarta. "We know we can't go for the best solution," she said. Nor can the country remain locked indefinitely in a standoff with the IMF. The most realistic outcome, she said, will be "to find the least distorting second best solution."

Tale of Two Cities: Two Mayors and the Impact of Local Communities

Lessons of civic activism, effective decentralization, grassroots environmentalism and good governance rarely come together in a single package. But the case of two mayors who shared their experiences at ADF illustrates how local communities can lead the way in new efforts in societal reform.

Richard Gordon, the 52-year-old mayor of Olongapo City, Philippines (pop. 250,000), helped lead his constituents through an overwhelming environmental problem that threatened not just the beauty but the health of the local community. Lacking financial resources to deal with the mountains of garbage that were daily dumped on the streets, Mayor Gordon pushed not just for legislation and strict law enforcement, but community participation in achieving his clean-up goals. By convincing people of the importance of clean streets to attracting investors, he mobilized his community to join in what was to become a successful program that today continues to change the face of his community.

Across the world in Bolivia, La Paz Mayor Ronald Maclean-Abaroa helped clean up his city's corrupt financial management. Redesigning city administrative systems and reinforcing accountability of local officials, he drew the public's eye onto the way their city was being managed. Corruption was punished, but good behavior was rewarded by increasing the salaries of efficient and honest employees. Not only did tax collections increase but also the effectiveness of how the city's money was being used.

Information shortages persist, even in the information age. According to Masaru Yoshitomi of the Wharton School, "globalization means that investors do not know much about each of the emerging markets because the cost of information-gathering is very high." With respect to East Asia, investors responded to the good macroeconomic fundamentals, but had trouble understanding the financial firms and corporate structures that kindled the crisis. □

ADF INTERVIEWS: WOMEN LEADERS AT THE FORUM

Close to 300 people from around Asia gathered at the Asia Development Forum to discuss the present crisis and the unfinished economic agenda of East Asia. Female economists, professors, policy-makers, and NGO leaders constituted about a quarter of participants. EDI interviewed Mari Pangestu and Atchaka Brimble on March 11. Dr. Pangestu leads the Center for Strategic and International Studies in Indonesia and Ms. Brimble is Director of the International Affairs Division of the Board of Investment of Thailand.

Mari Pangestu

Q: *What brought your country into the financial crisis?*

Dr. Pangestu: Both domestic and external factors played a role. The contagion factor led to the initial decline of the rupiah, because of similar structures (with neighboring Asian countries). Indonesia was seen as the best, and it initially made the right responses by tightening monetary policy. But things went wrong after the first IMF package, not because of the IMF package per se, but because of inconsistent domestic policies.

Q: *Domestically, what was wrong?*

Dr. Pangestu: Indonesia suffered from a weak financial system: overborrowing, exposure to risky sectors such as property, and too many banks. The set-up (for a financial crisis) was there, and it made the crisis worse.

Q: *Some Asians blame financial globalization, particularly international speculators, for this crisis. Do you share the view?*

Dr. Pangestu: Blaming globalization is a dangerous trend and we need to fight it. Globalization is not the cause of the crisis. The failure of institutions is the actual cause.

Q: *What will be the most important factor that will lead Asian countries to recovery?*

Dr. Pangestu: We have to have restoration of confidence. This is a difficult and complex answer. We need to restore the credibility of the government, not just in Indonesia, but in other countries as well because of the contagion effects; restore the banking sector, because the economy needs a normal, functioning banking sector; and to restore private sector debt. These are parallel developments." □

Atchaka Brimble

Q: *What are the most serious consequences of this financial crisis?*

Ms. Brimble: I would have to say the huge government bailout of finance companies that had considerable non-performing loans. It became a public burden.

Q: *How does this crisis bring change into the lives of workers, farmers, manufacturers and consumers?*

Ms. Brimble: Urban workers and consumers are badly affected in terms of higher prices and unemployment. The manufacturing sector is also affected, especially the automotive industry where domestic demand fell 60 percent. The impact on farmers is not clear. Although prices of consumer goods rose, so did the prices of agricultural products. This in a way helped reduce the negative effects on them. Many farmers, in fact, can now pay back their loans.

Q: *How is your government implementing the restructuring and reform conditions of the IMF and what is the biggest barrier?*

Ms. Brimble: For one, the definition of non-performing loans is now being made stricter. Before, 12 months was the period of non-payment for a loan to be considered non-performing. This was reduced to six months in December and is now down to three months. Banks are also being forced to recapitalize. Company assets are being auctioned off to pay back creditors.

Q: *What is the impact of the crisis on the political processes and governance?*

Ms. Brimble: People are now talking about the need to improve governance. Nobody knew the magnitude of the problem. I also think that the crisis will also push the public to agree to broader political reform. □

TOUR OF THE THINK TANKS

This financial crisis calls for pooling intellectual resources within the region. A session entitled Think Tanks as Development Agents allowed researchers from major think tanks in Asia to make contacts and exchange views on major issues. For a layperson, the meeting was also a good opportunity to compare notes with representatives of well-known think tanks in neighboring countries.

Thailand Development Research Institute--Thailand

The first policy research institute in Thailand. Non-profit and non-governmental. The major research areas are macroeconomic policy, science and technology, human resources and social development.

Institute of Southeast Asian Studies -- Singapore

An autonomous regional research centre for scholars and other specialists. A major publisher of scholarly books. Its focus is on Southeast Asia's socio-political change, economic development, as well as stability and security issues.

Malaysian Institute of Economic Research -- Malaysia

Independent and non-profit. Research focus is economic, financial and business issues.

Philippine Institute for Development Studies - - Philippines

The main research arm of the country's National Economic and Development Authority (NEDA). Non-stock and non-profit. Long-term policy-oriented research on social and economic development. It regularly gives out sound economic policy advice to the highest levels of the Philippine government. It produces numerous publications dealing with macroeconomic and sectoral issues affecting the country.

University for Asia and the Pacific -- Philippines

A private sector think tank that concentrates on business and economic research. The business community is its main client.

VIEWS FROM ADF PARTICIPANTS

What will you take home from ADF?

"It gives me more things to do."

**Romeo Acosta, Program Director,
Department of Environment and
Natural Resources, the Philippines**

"The return of confidence in the (Asian) economy."

**Emilio Antonio, Jr., Director,
Institute for Economic Policy Research**

"I am keen on the issue of community participation. I got lots of lessons from people with first-hand experiences and met people. Some were very good runs."

**Shankar Ghose, Executive Director,
National Foundation for India**

"We could learn from each other. Rising unemployment in crisis-hit countries is also our problem, as reform proceeds."

**Hong Wang, Professor, Dept. of Health
Economics, Beijing Medical Univ.**

"It helped better understanding of development related to this crisis."

**Paul Byrne, Rural Development
Consultant, Ireland**

"It was a good learning opportunity particularly with many speakers from advanced countries. Different culture and cross-questioning also interested me."

**Farrukh Sohail Goindi,
Pakistan Peoples Party**

"Perseverance -- continue on what you have started whether the crisis."

**Linda Medalla, Research Fellow,
Philippine Institute for Development
Studies**