POLICY INSTRUMENTS FOR THE

Return of Private Capital TO Asian Countries

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Broader change and deeper reforms, not less, are called for to relieve Asia's economic distress. Since globalization is "inevitable and irreversible," trade liberalization, privatization, and deregulation should continue, avoiding wholesale protectionism. Recommendations are reviewed from APEC Finance Ministers for freer flow of capital and from the IMF for adjusted macroeconomic policies, together with measures for reducing debt, corruption and mismanagement, and building social infrastructure.

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LESSONS FROM THE ASIAN CURRENCY CRISIS

An economic tempest has blown through Asia. Its proximate causes and origins are still under debate. Key international organizations that have long shared a common policy framework appear divided on what should be done, and forecasts of recovery differ. On the eve of the new millennium, Asia faces the enormous task of restoring both growth and stability in each of its member economies. Fundamental economic and financial restructuring must take place for the region to create the conditions for a balanced, equitable and sustainable growth and development.

The extent of economic devastation in each Asian country affected by the crisis differs significantly according to specific national structural conditions and policy responses. These include:

1. the amount of international debt;
2. the proportion of short-term international debt;
3. the adequacy of financial sector regulation;
4. the amount of foreign reserves available to the monetary authorities;
5. the tenacity with which the country defended its exchange rate;

6. the extent to which IMF-style high interest rates and bank closing were implemented; and
7. the ability of the political system to preserve social stability while coping with economic shocks.

Certainly, there are profound and far-reaching lessons to be learned from the Asian currency crisis. First, sound macroeconomic fundamentals by themselves are not sufficient to achieve sustained economic growth. The Asian crisis has shown that structural factors play a decisive role in a country's economic and financial health. Second, deeper attention should be given to the institutional capacity of the financial sector and to the proper sequencing of financial sector reforms in order that developing economies may reap the benefits of an open capital account regime. Third, developing domestic capital markets is crucial to the growth of the region. A well-functioning capital market can mobilize long-term capital and encourage more efficient allocation of resources under market forces. Fourth, the Asian crisis calls for a review of the effectiveness of existing international multilateral financial institutions, as well as posing new challenges to the global financial system.

The Asian crisis started basically as a problem of liquidity. In this regard, a system that enables international financial institutions to buttress countries in distress with a sufficient amount of liquidity is essential so that the governments can concentrate on structural reforms, especially on restructuring their feeble financial and corporate sectors, without unduly contracting their respective real economies. There is also a need to prepare a global structure to monitor international capital flows, whose sudden and large-scale reversal has proven devastating for capital-recipient countries.

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The Asian crisis has also demonstrated that equitable growth and sustainable development require more transparent and participatory governance structures, both in the public and private sector. Should a "new" Asian development model emerge from the ongoing crisis, it will need to include such elements as a larger and more active role for civil society, innovative forms of public-private partnerships, and strengthened financial systems to facilitate capital account liberalization. These systems, in turn, require improved supervision and prudential regulation of financial markets, as well as efforts to deepen and broaden capital markets.

The ongoing crisis has changed, and is profoundly changing the business environment in the region, the terms in which the region is dealing with its key partners throughout the world, as well as the mind-sets and perceptions within and outside the region. Nevertheless, a "new Asia" will gradually and, perhaps, painfully emerge from the crisis. But it will definitely be in a better position to play its role and take its share in the global economy of the 21st century. Undoubtedly, a healthier and reinvigorated Asia will ensue from the crisis. But we may ask:

- What will be the face, form and substance of the so-called "new Asia" after the crisis? What shall be its post-crisis financial infrastructure?
- Will the economic and financial restructuring lead to a "new Asian economic and development model"?
- How will the region face the challenge of good governance and of acquiring the software of globalization? What will be the scorecard of competitiveness in the region?
- On what terms, and to what extent, will Asia participate in a new and restructured global economy vis-à-vis its international partners and the international financial and economic community as a whole?
- What will be the effect and impact of a "new Asia" on regional cooperation, such as the Asia-Pacific Economic Cooperation (APEC) and the Association of Southeast Asian Nations (ASEAN)?
- What modalities should Asian banking and other institutional reforms adopt, at what pace, aiming for what results? What strategies should be adopted to cope with and manage tight capital? When and how will new financial instruments emerge? Will a so-called "new Asia" be able to achieve long-term and sustainable currency and fiscal stability?
- How will the information technology revolution and the knowledge-based economy reshape Asia, or mold the form and substance of a "new Asia"? What are its business, social and political implications?
- How will corporate restructuring and corporate governance impact on business prospects? How will the "new Asia" cope with its new consumer market?

These questions can help us think through not only what probably could have gone wrong in Asia in the past decade or so, but more important, determine what we need to prepare ourselves for in a new and more competitive global economy. Rather than engage in endless discourse about why and how the Asian crisis happened as it did, the more urgent task, especially for decision and policy-makers, is to identify challenges and prospects for bringing back renewed growth to their respective economies and to the region as a whole.

According to an economic theory, free movement of capital allows a more efficient global allocation of savings and directs resources toward their most efficient use. Indeed, the theory has proven itself in practice. International capital flows during the 1990s grew dramatically, with transactions in bonds and securities growing rapidly in both developed and developing countries. Furthermore, the composition of these flows also changed significantly — that is, foreign direct investment (FDI) and portfolio capital flows replaced commercial bank lending as the main source of international capital flows. Unprecedented advances in technology primarily account for this surge in international financial transactions which resulted in the abatement of costs for market participants, privatization of State assets, deregulation of financial markets in key industrial countries, growth of institutional investors, and macroeconomic and structural reforms in developing countries. This new economic setting has encouraged institutional and private investors to hold a wide range of international securities, while financial innovations and international competition have made it difficult for countries to control international capital flows.

Recognizing the imperatives of economic globalization, a significant number of countries, also in the 1990s, began to adhere to open market policies and capital accounts liberalization. As markets expanded and technologies reached new heights, emerging or developing economies, especially in Asia, became among the most attractive financial destinations. Thus, a binge occurred between both lenders and borrowers, resulting in market bubbles. Notable among the causes of the subsequent bursting of these market bubbles are the absence of effective structures among Asian financial institutions and the lack of independence or quality of management to adequately cope with the massive sums of money that were being aggressively thrust upon them by eager foreign bankers and investors. Foreign bankers and portfolio investors lacked the knowledge, experience and sophistication to understand the environments in which they were operating.

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ASIA BEYOND THE CRISIS

As fittingly expressed by Singapore's Ambassador-at-Large, Tommy Koh, the primary responsibility for pulling Asia out of its financial crisis lies with Asia itself. In the thick of the crisis, Asia is facing rising challenges ahead in its growth and development agenda. The critical and interrelated issues that need to be addressed include, among others, poverty reduction and alleviation, economic growth, financial sector development and environmental protection towards achieving equitable growth and sustainable development. Without sustained growth, poverty alleviation programmes fail, and the quality of life for a large proportion of the world's population will be seriously impaired; incomes in developing countries could fall even further behind those in the world's more affluent economies. These outcomes would not only be socially and economically divisive, but also destabilizing from the perspective of peace and security. Ultimately, growth in the developing world is crucial not just for global economic prosperity but also for global peace and harmony.

Over the past several decades, Asia has demonstrated to the world that it can triumph over various difficulties and emerge from crises brighter and stronger. It has strong economic fundamentals, resolute willingness to save for the future, an unwavering determination to continue open market policies, and a mutual recognition of the importance of motivating labour forces and emphasizing education. These are factors which will help build a healthier and stronger Asia in the path of its recovery. The "Asian miracle" was and is not a mirage. In spite of the crisis, Asia remains largely pro-business in its outlook and policies, and, thus, still

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attractive for business and investment. In the midst of the crisis, the world can still find opportunities for growth and strategic alliances in Asia. The key challenge for the international development community in the near future is to maintain the pace and focus of these critical reforms even in the face of a cyclical upturn; while allowing effective social participation, efficient market interaction, and informed policy-making through reliable information dissemination.

The outlook for the future of the region is not bleak at all. In fact, according to Alassane D. Ouattara, Deputy Managing Director, International Monetary Fund, the improving picture of Asia's future is due to the following factors, among others:

- The perseverance of the Asian crisis countries in pursuing stabilization and reform programmes;
- The easing of interest rates by most industrial countries, recognizing that the balance of global risks has shifted away from concern about inflation to a need for them to support growth;
- The adoption by Japan of new policy measures to stimulate domestic demand and tackle banking system problems with a view to reinvigorating its economy;
- The resistance of most countries to adopt protectionist and other market-closing measures, even in the face of competitiveness pressures and financial strains; and
- The measures taken by the international community to ensure that sufficient resources are at hand to assist countries in crisis.

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need to perceive and be assured of: stability and predictability. What is needed is a working, predictable political system; a reliable government; and a sound and stable banking and financial system.

SUSTAINABLE PROSPERITY FOR A "NEW ASIA" IN THE 21ST CENTURY: RECOMMENDATIONS

East Asia was a colonial backwater which suffered from centuries of wars and instability. Yet, it rose like a phoenix through intensive reconstruction, industrialization and interdependence with the larger economies: growth rates in the region soared and were generally acknowledged to be the highest and steadiest in the world. The region accounted for more than half of the world's growth in the past decade. No doubt, Asia will continue to be important to global strategists and to the world economy as a whole. The question is timing. Despite the diversity of the region's member-economies, there is convergence of interest among them, particularly in achieving sustainable economic growth and lasting social prosperity. Having been shaken by the crisis, Asia also needs to evolve a "new psychological paradigm" to counter self-defeating, sceptical mindsets that hamper the region's recovery. The region needs to overcome resistance to change, and instead restructure, not only for survival, but, most important, for long-term success. There also needs to be a collective resolve and political conviction among Asia's governments to resolutely undertake deeper reforms, innovations and commitment to social justice and interdependence. Social conflict and political unrest will negate efforts to achieve long-term and sustainable economic growth. Asia must now begin to move beyond defensive measures to innovative, breakthrough strategies, as well as devise more effective ways to enhance equity and efficient use of savings.

The world has a stake in the recovery of Asia. The entire global financial system is in jeopardy. Thus, global leadership has a shared responsibility in ensuring that the crisis in the region be abated as soon as possible, so that the task of rebuilding can commence forthwith. Asia's basic problem is clear and simple: shortage of cash flow due to illiquidity. The price of greater interdependence and deeper economic integration is inevitably that of shared risks and shared responsibility.

A consensus seems to be shaping up regarding reform strategies that need to be undertaken in order to relieve Asia from its present economic and financial distress and thus restore business and investors' confidence in the region, with the goal of achieving equitable growth and prosperity, and sustainable development. These strategies revolve around three main issues, namely:

1. macroeconomic policies;
2. structural reforms; and
3. the urgency of reviewing and reinforcing the global financial system.

Greater interdependence and deeper economic integration into the global financial markets require a high level of fiscal discipline. Since the collapse of the 200-year-old fixed exchange rate system in the early 1970s, exchange rate policies may be the most controversial and complex macroeconomic challenge in today's global markets. Of course, there is no single panacea suitable for all. Policy- and decision-makers must carefully examine the costs and benefits of alternative regimes. They should take into account the willingness of the political system to support adjustments through domestic demand, balance-of-payments trends, and the global environment. Perhaps they should adopt or maintain a more flexible currency exchange system that can be more resilient to, or withstand, the strains and shocks of the highly volatile global financial system.

Homework always begins at home. Asian governments must make more fiscally logical and defensible allocations of their assets. There must be a collective cognizance among Asian governments that, in carrying out reforms, in the struggle to regain positive growth in the short- and medium-term, they must work toward more political and economic transparency, as well as ensure political stability and food security for all its peoples. Again, social and political instability is one sure way of driving business and investors away from the region — even without a crisis.

There is no stopping the wave of globalization. Divergent views about world economics and finance are emerging, that is, whether or not globalization generates higher growth and prosperity or weakens national sovereignty and social cohesion. The debate, however, has shifted positively from appraising the costs of assent, to considering strategies that will more equitably regulate and distribute the benefits of a process increasingly being recognized as inevitable and irreversible. Thus, Asian governments must maintain their commitment to open markets, continuing trade liberalization and facilitation, and ongoing privatization, deregulation and stronger competition policies, as well as resist temptations to install wholesale protectionist measures.

By enacting and implementing clear, consistent, prudent and sound trade, investment and fiscal policies, in harmony with international guidelines, such as those provided by the World Trade Organization (WTO), Asian governments should be able to again attract foreign direct investments (FDI) and other

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cross-border capital inflows, while, in the process, accumulating transfer of technology. Effective technology transfer is one of the best ways of equipping and preparing Asia's vast reservoir of human resources for an era where intellectual capital will be a key tool in advancing Asia's modernization and competitiveness.

Moreover, there must be a thorough review of, and the establishment of concrete standards for, all classifications of "governance" issues needed to regain investors' confidence. Asian governments must be bold enough to check various abuses associated with "crony capitalism". Only by restoring capital flows can Asia truly resume growth, and only by resuming growth can it reverse the major income losses that have caused widespread hunger and imperilled the livelihoods of so many people in such a short time. Improved governance must include:

- establishing strong prudential standards and supervisory procedures for the banking system;
- greater transparency in financial reporting standards and accounting requirements;
- improvements to many current opaque, and sometimes even vague, legal areas, such as more practical bankruptcy procedures and better mediation services; and
- stronger corporate governance standards and requirements. The legal underpinnings of corporate governance should be clarified, especially to protect minority shareholders. Part of the vulnerability to financial panic arises from the lack of clarity of property rights within the emerging/developing market economies.

The globalization process has exposed many long-standing practices and structures that are principal reasons for the susceptibility and weakness of the international financial system. In a world where capital can move suddenly and massively — with facility and ease, and, sometimes, even with impunity — structural patterns that are incompatible with global standards must be revised or abandoned if we are to reach a more stable phase of economic and financial integration. National authorities should address key structural deficiencies, while governments, multilateral agencies and market participants should articulate clear standards for sustainable participation in global finance.

Considering the virulence and global implications of the Asian crisis, regional multilateral bodies have, likewise, moved swiftly to consolidate reform efforts in the region. For instance, the APEC Finance Ministers have agreed on the following initiatives to facilitate increased private sector participation in infrastructure, promote the development of financial and capital markets, and support the freer flow of capital:

- Enhancing cooperation among export-financing institutions in order to maximize their catalytic role in attracting private funds and in helping shape the region's economic climate to reduce risks while providing adequate return on investment;

- Strengthening financial market supervision in order to keep up with rapid changes in international financial markets;
- Strengthening clearing and settlement infrastructure;
- Supporting development of credit-rating agencies and strengthening information disclosure standards to help develop the region's capital markets and attract cross-border capital flows;
- Establishing a regional forum on pension fund reform to help boost domestic savings; and
- Establishing a regional forum on securitization as a viable mechanism for financing economic growth.

The Asian crisis highlights the importance of a sound macroeconomic policy framework, and the perils of having unsustainably large current account deficits. Beyond this, the International Monetary Fund (IMF) has identified six major areas where initiatives already underway should be strengthened:

- More effective surveillance over countries' economic policies and practices, facilitated by fuller disclosure of all relevant economic and financial data;
- Financial sector reform, including better prudential regulation and supervision;
- Ensuring that the integration of international financial markets is orderly and properly sequenced (supported by, among other things, a sound financial sector and appropriate macroeconomic and exchange rate policies) in order to maximize the benefits from and minimize the risks of international capital movements;
- Promoting regional surveillance;
- A worldwide effort to promote good governance and fight against corruption, including the adoption by the Interim Committee of the Board of Governors of the IMF on 16 April 1998 of the "Code of Good Practices on Fiscal Transparency — Declaration of Principles" to serve as a guide for members, and to enhance the accountability and credibility of fiscal policy as a key feature of good governance; and
- More effective structures for orderly debt workouts, including better bankruptcy laws at the national level and better ways at the international level of associating private sector creditors and investors with official efforts to help resolve sovereign and private debt problems.

Nonetheless, in spite of the foregoing backdrop, perhaps the most serious and pressing problem of the Asian crisis-countries remains the large amount of bad debts in their respective banking and corporate sectors. Although a series of negotiations between the creditors and debtors has been initiated to restructure debts since 1997, there is much merit in curbing lending booms associated with capital inflows while addressing the underlying weakness in the banking system. The development of well-functioning capital markets will reduce risks of potential instability, as well as attract a growing pool of portfolio investment. Indeed, the volatility of short-term financial flows, especially in the advent of the information technology revolution, poses a formidable challenge for policy- and decision-makers. There is no simple or single solution to this dilemma. Yet, a combination in the following action-areas may provide some relief:

1. a sound blending of fiscal and monetary policies;
2. elimination of artificial incentives to short-term flows, as well as disincentives to long-term debt and direct investment flows;
3. reinforced risk management by investors and lenders;
4. shrewd measures that provide incentives for better asset and liability management practices;
5. increased disclosure; and
6. consideration of the need for supervisory arrangements for highly leveraged firms engaged in global finance.

However, the paramount long-term challenge for Asia is in building its social "software" or infrastructure, rather than in fiscal regulation, macroeconomic stability or exchange rate management. Asia's flawed social infrastructure and inadequate political institutions allowed for too much corruption and mismanagement. In an increasingly competitive world, where FDI and other cross-border capital flows are courted not only by Asia, but also aggressively by Central Europe and Latin America, concerns over governance are bound to heighten. That is why Asian governments must seriously and persistently invest in harnessing cutting-edge technologies and skilled manpower, as well as in setting up adequate social infrastructure and safety nets toward the goal of achieving equitable economic growth and lasting development and prosperity.

In the context of the Asian financial crisis, profound questions have been raised about the quality, transparency and responsiveness of the IMF to the financial problems faced by the developing countries. Likewise, questions have been raised regarding the balance-of-interests at play in global negotiations on environment, trade and capital mobility, among others. Are the developing countries truly represented or is their participation marginalized? Or, are the international negotiations run for and by the developed or industrialized economies, which represent a mere 15 per cent or so of the world's population? The intensification of criticisms against existing international, multilateral financial institutions has led to a demand for sweeping reforms, such as improved financial data, stronger supervision of banking systems, greater transparency and methods to ensure that private sector actors commit and stay where they are when things go wrong.

Perhaps, the proposal for the creation of a "G7+7" (to include the major emerging/developing markets/economies from each hemisphere) merits closer scrutiny and stronger support. Perhaps, too, this is one mechanism that could effectively broaden the democratic base and participation of developing nations in shaping world affairs and in deciding their fate for the next century — before the systemic risk to the world economy and the need to arrest the financial crisis gets any worse, if ever.

Nevertheless, regardless of the teeming debates about the subject and the extent of reform packages for the region, investors and capital will come to Asia only when they see very clear policy directions and a strong determination to pursue and put in place much needed reforms from its leaders. Asia needs to undertake a tremendous amount of re-engineering to better cope with a highly integrated and globalized economy. In the new economic milieu of the 21st century, Asian leaders need to be more open to change, more accepting of the need for greater interdependence and integration (as well as greater volatility), and committed to open management and far-reaching social development. In the end, the form and substance of the "new" Asia economic and development paradigm must bear a human face. ■

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