Conference on

Economic Crisis and Recovery:

Enhancing Resilience, Structural Reform, and Freer Trade in the Asia-Pacific Region

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"Broadening Openness and Reform for a Resilient Asia"

at
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Conference on "Economic Crisis and Recovery: Enhancing Resilience, Structural Reform and Freer Trade in the Asia-Pacific Region"

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I. Introduction

Excellencies, distinguished guests, ladies and gentlemen,

I would like to thank our hosts from the Pacific Economic Cooperation Council and SINCPEC for organizing this conference. It is encouraging to see such a group of high-level officials, diplomats, scholars from academia and the private sector here today.

As the world begins its recovery from the global recession, people are asking what can be done—not only to prevent a recurrence, but to make global and regional economies more resilient. Financial globalization has clearly challenged national governments and international agencies to better manage financial risk and minimize uncertainty. We know we need stronger supervision and financial market regulation. The question is how do we balance regulatory control with the market-driven economic growth that has served our region so well over the past decades?

For Asia, the main channel of the crisis' contagion was not the sudden, massive withdrawal of capital—as occurred during the 1997/98 Asian financial crisis. The financial meltdown last year indeed affected our financial systems, but we were far better prepared than in 1997. Rather, it was the onset of severe recession in the industrial world that brought the crisis to our shores. Asia's reliance on external demand for growth has helped many economies. But we should be careful not to overly rely on a source of growth that is likely to decrease over the short and medium term. As consumers in countries like the US try to rebuild their balance sheets, we are unlikely to see a return to the surging external demand to which we have become accustomed.

Asia’s developing economies, particularly those more open and export-driven—such as Singapore—were hit hard by the severe contraction in the advanced G3 economies. Industrial production fell drastically as export demand melted away beginning in the latter half of 2008.

Yet Asia is now showing strong signs of rebounding. In fact, ADB had forecast in March that developing Asia would grow by 3.4% this year and 6.0% in 2010. But we recently modified these forecasts upward—to 3.9% in 2009 and 6.4% next year. Why has Asia been able to show this remarkable turnaround?

This afternoon, I would like to answer this by briefly describing why developing Asia’s policy makers had sufficient room to proactively respond to the crisis. Then I will explain why we must broaden Asia's economic openness to build greater resilience, and how domestic reforms—building human security by bolstering social safety nets and small and medium enterprises, for example—can contribute to the regional resilience we all seek.

II. Asian Policy Responses to the Crisis

One major factor in Asia’s quick turnaround in the face of global recession was its rapid—and in many cases coordinated—policy response. The spike in oil, food, and other commodity prices reversed in the latter half of 2008. This reduced inflation pressures, particularly in the larger commodity-importing countries of developing Asia, where monetary authorities tightened policy rates as inflationary pressures mounted. This left plenty of room for Asia’s central banks to lower policy rates to help provide credit and liquidity when the crunch hit. This helped sustain domestic consumption and investment demand. Major fiscal stimulus also boosted demand and growth prospects. But it has become clear that China is playing its part in driving regional demand—as its share and volume of region’s exports of final goods to China have begun to pick up. With oil prices less than half of what they were in the middle of last year, Asian oil importers have also seen improved terms of trade and have more income to spend on non-oil items.

Asia's relative financial stability in the face of financial market turmoil in industrial countries is another major factor. Asia’s banking systems were rebuilt after 1997 with an eye on maintaining sufficient prudential limits—particularly in eliminating nonperforming assets and boosting capital asset ratios. So when the crisis hit, they were able to provide credit for consumer durables—and even property and real estate—at lower interest rates than their peaks last year. This has also given impetus to the turnaround. Industrial and export orders are now beginning to recover. And the result could well be a V-shaped recovery for the region.

But it is clear that Asia will be unable to fully return to its rapid pre-crisis growth rates unless recovery is sustained globally as well. Thus, poverty reduction will not be able to resume at anywhere near the pace of the pre-crisis years unless we work toward rebalancing our sources of growth more toward domestic demand, and in a way that is more inclusive. It is imperative for the region to find a pathway back to robust but sustainable growth so the poor are not left behind.

III. Broadening Openness for a Resilient Asia

It is now recognized that unless the underlying problems that caused the crisis are resolved, there will be at best a gradual recovery characterized by anemic global growth. Therefore it is in Asia's own interests, and the world's, to rebalance the sources of growth, allowing surplus countries and regions to emphasize consumption, while deficit countries and regions to improve net exports. Large current account deficits in industrialized economies—funded largely by surpluses generated in Asia—have proved to be unsustainable.

The outward-oriented Asian growth model has brought tremendous benefits to the region in the past and can continue to do so in the future. It would serve no one to turn inward—and protectionism should be avoided at all cost. But the concentration on G3 markets for final product sales needs adjustment. We must work toward greater diversification in the direction of trade—including the promotion of intraregional trade—if Asia is to return to its growth potential.

The 2008/09 crisis exposed developing Asia's over-reliance on extra-regional markets for both exports and capital flows.

Asia's policy makers need to develop policies that can help build domestic capacity and enhance regional cooperation—to bolster economic resilience and reduce vulnerability to external shocks. Expanding intraregional trade—especially for final goods—can help reduce developing Asia's overdependence on exports to industrial countries. It can also provide an additional engine for short-run recovery and long-term growth. Achieving this will require removal of barriers to intraregional trade, particularly behind-the-border obstacles to freer trade in goods and services; and cooperation to institutionalize concrete and specific initiatives to ease intraregional trade. At the same time, the region must pursue an open regionalism that promotes global free trade.

Effectively managing financial globalization can ensure that capital flows are less destabilizing to the region's economies. Improving the investment climate will help shift the composition of foreign capital to less volatile longer-term inflows. Stronger domestic financial markets with requisite oversight mechanisms, appropriate levels of foreign exchange reserves, and the establishment of regional capital markets will also increase financial stability.

We have learned much from this crisis—as we did during our own financial crisis in 1997. We know how important a sound financial system is for sustained economic growth. Twelve years ago we took our lessons seriously. We overhauled our banking sectors. We realized the importance of developing capital markets, particularly bond markets, as an alternative to bank finance. We strengthened prudential indicators across emerging East Asia's financial systems, which helped shield banking systems from the global meltdown. But with the exceptions of a few advanced markets, most Asian economies still struggle with largely underdeveloped financial systems. Our aim must be to encourage financial innovation while strengthening financial regulation and supervision. Striking the right balance between regulation and innovation is essential for effective financial development.

IV. Crisis as Opportunity: "Human Security" via Social Safety Nets and promoting SMEs

Broadening and restructuring developing Asia's openness will complement other rebalancing policies, such as the strengthening of social safety nets, health care, job skills, and opportunities for new enterprises, particularly small- and medium-sized enterprises (SMEs). Economic crises are most difficult for the most vulnerable—particularly the poor. This crisis is no different. An ADB study estimates that, had the region's high growth continued in 2009, we would have at least 60 million fewer people living in extreme poverty—on less than $1.25 a day.

Obviously, unemployment and declining earnings during times of crisis create severe hardships for affected workers and their families. Social safety nets can alleviate these hardships. But the benefits of building social safety nets go well beyond this. This is because a crisis can have adverse *long-term* effects on the development of human capital among the poor and vulnerable families if, for example, they must pull their children out of school, or leave a chronic illness untreated. In addition, social safety nets help keep aggregate demand from falling too much in times of crisis.

China's efforts to expand basic health insurance for the poor, for instance, exemplify a win–win situation for individual households and society alike. The poor get much needed health care, thereby protecting their productivity and income. But over time, they will also have less need for accumulating large "precautionary savings" as self insurance and, instead, will either increase consumption or save and invest more productively. Either of these will benefit the wider economy as well.

Governments have historically "not let a crisis go to waste," so to speak. Indonesia, for example, introduced a National Safety Net Program, building on pilot projects involving conditional cash transfers and provisions of block grants to poor communities after the 1997 crisis. This undoubtedly helped Indonesia alleviate the plight of those hit hard by the crisis, especially the poor. Thailand similarly introduced widespread health insurance after the 1997 crisis.

We must ensure that in this crisis too, we take the necessary steps toward building effective social safety nets. How they are structured and designed will undoubtedly differ according to specific country circumstances. But they can include labor-intensive public works, cash transfers, and fee waivers for essential services, such as education, health care, and nutrition. They can also include training for recently dismissed or unemployed workers from vulnerable groups, and systems that provide job information and placement services for the recently unemployed.

The success of rebalancing will also depend on the emergence of a large and rapidly growing middle class. This in turn hinges on the dynamism of Asian business, especially SMEs, where a large number of Asian workers are employed. SMEs account for nearly 50% of manufacturing jobs in Malaysia and China, and a massive 90% in India. Outside of manufacturing, the numbers are even larger.

But SMEs often operate under difficult circumstances. They are especially disadvantaged when they need to access finance. They also often are first to feel the brunt of weak infrastructure. Market failures can limit their ability to adopt new technologies. And poorly designed regulations or policies can weaken incentives to expand.

These issues must be addressed. Government programs to help smaller enterprises access finance must work with commercial forces to correct market failures. They must improve the institutional underpinnings of financial transactions by strengthening creditor rights, defining property rights to allow these assets to be used as collateral, and enhancing credit registries and systems to screen borrowers. Governments can also assist firms by providing information services on technology and markets, vocational training, and technical support services, and by fostering linkages between SMEs and large enterprises.

V. Conclusion

In closing, developing Asia is set to emerge from the global slump ahead of the rest of the world. It is still too early to relax vigorous efforts to restore demand and stabilize financial systems. However, for the recovery to return to sustained growth, we cannot simply return to our old ways. By broadening economic openness and strengthening economic cooperation and integration regionally, Asia can help the rest of the world and at the same time make our own economies more resilient. Strengthening social safety nets in response to this crisis will also complement these measures. I look forward to hearing your views on how we can—together—work to ensure that the recovery puts us all back on a sustainable high growth path to greater prosperity and poverty reduction.

Thank you.