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The Asian Financial Crisis and the Opportunities of Globalization

Address by Michel Camdessus
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at the Second Committee of the United Nations General Assembly
New York, October 31, 1997

In these days of global markets and market turbulence, discussion of the international economy—in the Second Committee and other fora—necessarily turns to the effects of globalization. And since globalization is a challenge for all, we all have an obligation to ask ourselves what it implies for the terms of our partnership.

Certainly, there is very broad recognition of the benefits of global financial markets: they give countries new opportunities to quicken the pace of investment, job creation, and growth; they give investors a wider range of investment opportunities and higher returns on savings; they promote a more efficient allocation of resources worldwide and thus, stronger world growth. Global financial markets also provide countries with additional incentives to pursue sound macroeconomic policies and overcome structural weaknesses that impede investment and growth.

Yet there is also apprehension about the very serious risks associated with globalization. Indeed, today countries are more vulnerable to shifts in market sentiment regarding their economic situation or policies. Changes in market perceptions can trigger massive shifts in capital that can, in turn, precipitate banking sector crises and have serious spillover effects in other economies. Moreover, some countries are not well equipped to take advantage of the expansion of world trade and capital flows and therefore risk becoming marginalized from the world economy.

Present developments in southeast Asia show that these risks are significant. But it would be a mistake to conclude that they are insurmountable or to allow them to obscure the benefits of globalization. The balance of benefits and risks facing countries in the global economy depends largely on how well countries adapt, individually and collectively, to the new global economic environment and on how quickly and appropriately they react to changes in this environment and in their own domestic economies. The IMF, with surveillance over the economic policies and performance of its 181 member countries, is in a good position to observe how countries are dealing with the challenges of globalization and to distill the lessons of their experience. In my remarks today, I would like to discuss these lessons and the increased responsibilities they imply for national policymakers. Then I will turn to their implications for our global partnership and the IMF.

Lessons of experience

To begin, let me review the experience that is uppermost in many people's minds: southeast Asia. How could events unfold as they have, after so many years of outstanding economic performance?

As you know, the difficulties in the region began in Thailand, where signs of emerging macroeconomic problems, including a loss of external competitiveness, had been apparent for some time. These problems, in turn, exposed underlying weaknesses in the domestic economy, including a fragile and over-exposed financial system, an inflated property market, and high levels of short-term foreign borrowing by the private sector. Finally, in the absence of sufficient policy measures, the crisis broke. The market's anxieties then spread to other countries in the region and, more recently, to financial markets elsewhere in the world.

As developments have shown, confidence, once lost, is hard to regain. Restoring confidence takes a strong commitment to economic adjustment and reform demonstrated by the implementation of often painful measures. It also requires a free flow of timely, accurate and comprehensive information so that markets can assess the extent of underlying problems and the seriousness of efforts to correct them and uncertainty is reduced. And, of course, restoring confidence takes time.

This process is now under way in southeast Asia. With the support of the IMF, Japan, and a number of other countries in the region, Thailand has launched a courageous and comprehensive program that addresses market concerns about large external deficits and troubled financial institutions. As a result, the budget is moving back into surplus and a comprehensive restructuring of the financial sector is getting under way. The Philippines, for its part, has taken necessary measures and extended its program with the IMF under which a substantial amount of economic adjustment and reform had already taken place. Indonesia has also strengthened its policy stance in continuous dialogue with us, and as recently as last night, it has reached agreement with the Fund on a major program to strengthen its financial system and provide a framework for a lasting recovery from the current situation. It was my privilege to announce this morning that the Fund intends to support this program with a loan of \$10 billion in a total package of \$23 billion, of which \$18 billion will consist of multilateral financing. On top of that, a contingency safety net is being established through which an important group of countries have declared their readiness to complement our package in the case of unexpected need. Malaysia is also adapting to changing conditions, by scaling back investment plans, tightening its fiscal stance, and strengthening prudential banking regulations.

Naturally, it will take time for these efforts to bear fruit. It is encouraging, however, that all of these countries are relying increasingly on measures to strengthen economic fundamentals, rather than on controls. Hence, my confidence that, after this period of adjustment, these economies will emerge stronger than before, as Mexico has, following the peso crisis in 1994-95. In the meantime, however, there is much to be learned from this experience about economic management in new global environment. Even if it is still too early to map out all of the lessons in full, some important ones are already very clear.

The main conclusion to be drawn is the obvious one: the world economy is different today than it was even ten years ago. Increasing economic and financial integration has produced a much more interdependent world. As a result, an increasing number of countries have the ability, through their policy action or inaction, to influence economic and financial developments far beyond their own borders—sometimes for the better, as in the early 1990s when the dynamism of developing countries helped cushion the effects of successive downturns in industrial economies, and sometimes for the worse, as is now the case. Moreover, market anxieties can quickly spread from one economy to another, and economic weaknesses that might otherwise have escaped much market scrutiny can now attract intense market interest. Clearly, this more demanding global context presents new challenges for economic policy. In my view, these challenges can only be met if we are able to give a new dimension to our global partnership—that is, if we can develop a more acute and far-reaching sense of national responsibility and more effective global solidarity. Let me outline what these must involve.

Responsibility

Responsibility involves many things; let me mention three important aspects of it. First, a country's responsibility to its neighbors and partners. Contagion effects can be so rapid, so overwhelming, so costly and unfair to countries with generally sound policies that, no doubt, the first responsibility is to "keep your house in order." The larger the economy, the more compelling this responsibility, but no country is exempt from this obligation to other countries. Surely, no country should accept the risk of becoming the tinder for a wider conflagration.

Keeping one's house in order implies responsibility vis-à-vis national policies: avoiding macroeconomic imbalances and correcting them promptly when they arise;

making cost-effective use of public resources; explaining to citizens when and why policy changes are required so that they understand and support the direction of economic policy; and undertaking the often difficult structural reforms needed to sustain growth in a timely manner. This second aspect of responsibility also involves getting policy priorities right. In Asia, for example, this means that countries must give priority to the pressing business of improving current account positions and strengthening financial sectors, rather than to spurring growth at unsustainable rates.

Does all this sound like familiar advice from the IMF? Undoubtedly so. But may I suggest that this emphasis on the proper mix of monetary and fiscal policies and the structural reforms needed to underpin them should also be high on the agenda of all those who value high-quality growth, especially those who are concerned about the poor and the most vulnerable in our societies. For indeed, it is they who are most likely to suffer during economic downturns and periods of high inflation.

Getting the priorities right also means that efforts to press on with macroeconomic adjustment must not delay other reforms that will enhance growth, accelerate human development, and ensure that the benefits of growth are widely shared. It is now recognized that these latter objectives require not only macroeconomic stabilization, but also a range of broader reforms—a "second generation" of reform—to develop the institutional framework and human capital on which well-developed market economy depends. These second generation reforms to strengthen judicial systems, make public institutions more accountable, improve the quality of public expenditure, level the playing field for private sector initiative, and otherwise create a more favorable climate for long-term investment are not the icing on the cake, but essential ingredients in achieving sustained, high-quality growth, and they are particularly beneficial to the poorest segments of the population. Our program in Indonesia should be a good illustration of it.

Third, vis-à-vis the market, responsibility involves maintaining the proper perspective about the benefits of private capital flows. Certainly, there are risks in tapping global markets to which no country is immune. At times, markets can be slow to react to changes in economic conditions and then over-react with brutal force; in other instances, herd instinct seems to prevail. But let us not forget that markets also provide tremendous opportunities to accelerate growth and development, as southeast Asia itself so vividly shows. Thus, the lesson to be drawn from recent developments is not about the risks of globalization, but rather about the importance of approaching markets in a responsible manner—with sound macroeconomic fundamentals that give markets confidence and do not invite reckless market behavior; with respect for the signals that markets provide; and with transparent and market-friendly policies that allow markets to allocate resources efficiently.

International solidarity

All that I have described will require enormous efforts on the part of individual countries. What can their partners in the global economy—their neighbors, advanced economies, the IMF, and others—do to support their efforts?

One avenue for more effective international partnership would be for countries to complement IMF surveillance by joining voluntarily with their neighbors in mutual surveillance on a regional basis. The purpose should be to develop a "club spirit" through which neighboring countries can encourage one another—and, at times, exert some peer pressure on one another—to pursue sound policies. This would be a most valuable contribution to global stability. To be effective, such regional surveillance will have to be based on a sound analysis of the economic situation. The management and staff of the IMF are ready to contribute to regional surveillance in Asia, as they already do in Europe, the G-7, and other fora.

International partnership also calls upon the international community to give greater support to the poorest countries that are struggling to participate in global markets. Certainly, there is much that needs to be done to create a more welcoming and secure environment for domestic and foreign investment in these countries. But even the countries that have made significant progress on economic reform do not yet attract enough investment. For them, foreign aid remains crucial.

I will not repeat today what I have said on so many other occasions about the responsibility of advanced economies to help integrate the poorest countries into the global economy; to recognize that their ODA budgets are one of the best investments in building a more secure and prosperous world; to open their markets, especially to products in which the poorest countries have a comparative advantage; to prosecute their nationals if they take part in corrupt practices in foreign countries; to refrain from promoting unproductive military expenditure through aggressive export strategies; and to avoid wasteful military buildups. But on this much, I must insist: the world is too small, its problems too easily transmitted across international borders, to allow some countries to slip farther and farther behind in terms of growth and development.

Finally, as there are so many challenges that exceed the capacity of individual countries acting alone, partnership also means strengthening multilateral institutions. IMF members recognize this imperative, and that is why they have called upon the Fund to enhance its capacity to help all members deal with the changes in the global economy. Let me comment briefly on how the Fund is responding with the full support of its membership.

The IMF's response

The Fund's response centers on four broad areas.

First, in order to detect financial tensions as early as possible, we have strengthened Fund surveillance, which, as you know, lies at the heart of the IMF's efforts to maintain an orderly international monetary system. In particular, we have sought to make our dialogue with member countries more continuous and probing and put more emphasis on the continuous and timely provision of data. We are also concentrating more on policies decided at a regional level, on the regional implications of national economic policies, on banking and financial sector soundness, and on the policies and institutions that sound financial systems require.

Second, we are doing what we can to help markets function more smoothly. Considerable progress has been made in liberalizing current account transactions worldwide so that countries can take advantage of the opportunities offered by the expansion of world trade. Now, with the globalization of financial markets, the emphasis is turning to the need to foster an orderly liberalization of capital account transactions. There is agreement that the IMF Articles should be amended to make the liberalization of capital movements one of the purposes of the Fund and to extend the Fund's jurisdiction to capital movements, with appropriate safeguards and transitional arrangements to ensure that liberalization is neither premature nor unduly delayed.

At the same time, the Fund is actively encouraging all countries to be transparent about their economic performance by improving the dissemination of economic and financial data to the public. Greater transparency will help to strengthen market discipline and avoid market surprises that can lead to disruptive market reactions. To this end, the Fund has developed a set of standards regarding the quality, coverage, frequency, and timeliness of data made available to the public and has established a Dissemination Standards Bulletin Board on the Internet to which 43 countries have now subscribed. Procedures have also been put in place through which countries can make known to the markets, and to the public in general, the Fund's views on their economic policies and situation.

Recognizing the importance for growth of creating an environment that encourages private sector activity, the Fund has also become more active—in close collaboration with the World Bank, regional development banks, and the UN institutions—in promoting the "second generation" reforms that I referred to earlier. These include developing an institutional framework that will, among other things, provide an efficient, professional justice system, help limit arbitrary and corrupt government practices, and set clear regulatory and supervisory standards for markets, including financial markets. They also include policies to improve the quality of public expenditure, ensuring adequate allocations for education and health to help ensure that individuals are able to realize their potential to participate actively in a market economy, and providing social protection to those who bear the brunt of the changes of a dynamic economy. Some of these reforms are particularly complex.

Third, the Fund has taken action on several fronts to strengthen its resource base and adapt its procedures and financing facilities. As you may know, the membership has just agreed to an increase of 45 percent, equivalent to about $90 billion, in IMF quotas. This will raise the capital base of the institution to some $290 billion. In addition, the Fund has taken steps to augment its financial resources through the agreement on the New Arrangements to Borrow, which we hope will enter into force soon. Under these arrangements, participants would be prepared to lend up to the equivalent of some $47 billion when additional resources are needed to forestall or cope with an impairment of the international monetary system, or deal with an exceptional situation that poses a threat to the stability of the system.

Furthermore, in order to allow all members to participate on an equitable basis in the SDR system, agreement has been reached on a proposal to amend the Fund's Articles of Agreement to authorize a special one-time allocation of SDRs of about $30 billion that would equalize all members' ratios of SDR allocations to quotas and would double the amount of SDRs allocated to date. These resources will supplement their reserves, giving them more flexibility in economic policies and a cushion against adverse developments.

The Fund has also established an emergency financing mechanism to allow financial assistance to be provided more speedily, when countries facing external crises are willing to take strong corrective action. This mechanism was used to expedite the recent programs for the Philippines and Thailand and will come into play for Indonesia, as well. In addition, the Fund has expanded the scope of its emergency assistance to cover countries in post-conflict situations, including most recently Bosnia and Rwanda.

Fourth, to reduce the risks of marginalization for the poorest of our members, we have adapted the Fund's facilities to their particular needs. In addition to providing concessional assistance, the ESAF is also the vehicle by which the Fund will contribute to the joint IMF/World Bank initiative to relieve the debt burdens of heavily indebted poor countries. So far, about $1.5 billion has been committed by multilateral and bilateral lenders for Bolivia, Burkina Faso, and Uganda, and six other countries have been identified for debt reduction.

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We will never be able to eliminate all the risks or costs associated with globalization, but as you can see, there is much that countries can do to reduce these risks and many ways in which the IMF and other multilateral mechanisms can help not only in coping with these risks, but also in taking full advantage of the renewed opportunities offered by globalization. This leads me to conclude that the silver lining in the recent developments in southeast Asia is not only that the economies involved will emerge stronger than before. But also that these developments have underscored the world economy's interdependence, alerted countries to the heightened need for responsibility in the conduct of economic policy, and I hope, summoned countries to more effective global partnership.