

PASCN Discussion Paper No. 99-08

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De La Salle University

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Can ECOTECH Alleviate the Asian Financial Crisis?

Dr. Angelo Unite and Dr. Wilfrido Villacorta*

This paper has the following objectives: (1) to describe the financial crisis and its causes, (b) to provide a background on ECOTECH as a major APEC concern, and (c) to examine the potential of ECOTECH in addressing the Asian financial crisis.

The Asian Financial Crisis

Several economists have offered a variety of arguments on the causes of the so-called Asian financial crisis that commenced on the second half of 1997. The hypothesized causes revolve around a common theme: lack of prudent financial institutions and effective regulatory/supervisory structures to cope with the consequences of increasingly integrated international capital markets.

Garnaut (1998) argues that the Asian financial crisis was a case of mismanagement of short-term macroeconomic policy, which was exacerbated by the increased international capital mobility in the 1990s. Garnaut cites the significant reduction in official barriers to international capital movements among the Asian economies as a factor responsible for enhanced international capital mobility in the region, which in turn contributed to exposing the weaknesses in macroeconomic management among these economies, primarily in the exchange rate regimes. He asserts that financial instability rapidly spread throughout East Asia when both domestic and foreign investors realized that (1) “presumed government guarantees of currency parities, and in various ways of asset values, were not guarantees at all” and (2) “they had poor understanding of the workings of the economies in which they were exposed” especially in countries with less transparent and less effective corporate and financial regulatory systems.

On the other hand, Krugman (1998a, 1998b) argues that currencies and exchange rates are merely symptoms rather than causes of the Asian crisis. He suggests a moral hazard/asset bubble model that he believes is the primary mechanism of the Asian crisis. In his view, the crisis started “with financial intermediaries whose abilities were perceived as having an implicit government guarantee, but were essentially unregulated and therefore subject to severe moral hazard problems.” The presence of moral hazard produced excessive risky lending of these institutions, which in turn led to inflation of asset prices. Furthermore, the financial condition of the intermediaries appeared much healthier than it was as a result of sustained overpricing of assets.

Then the bubble burst. Krugman avers that “the mechanism of crisis involved the same circular process in reverse: falling asset prices made the insolvency of

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intermediaries visible, forcing them to cease operations, leading to further asset deflation.” He thinks that this same process can explain both the marked severity of the crisis and the vulnerability of the Asian economies to self-fulfilling crisis, which, in turn, explains why the contagion effect even between economies with little economic linkages is possible.

For her part, Chia (1998) attributes the financial crisis primarily to “massive reversed outflow of foreign short-term unhedged capital” but also recognizes (1) “asset bubble with massive investments in property and stock markets, capital account liberalization with weak domestic financial system” and (2) “industrial subsidies and crony capitalism, inadequate surveillance and prudential controls of financial sector with lack of transparency and accountability” as some of the secondary factors that led to the financial crisis in the Asian region. Similar analyses are echoed in Kawai (1997), Magdaluyo (1998), Nasution (1998), ADB and World Bank (1998), and Oh (1998).

APEC Leaders’ View of the Crisis

In their declaration after the Kuala Lumpur summit, the APEC economic leaders seemed to have regarded ECOTECH as one of the antidotes to the financial crisis. They reaffirmed “our confidence in the strong economic fundamentals and prospects for recovery for the economies of the Asia Pacific” and gave emphasis to “Capacity Building” across the broad range of APEC activities. They identified human resources development, technological upgrading, infrastructure improvements and wider outreach to SMEs--which are concerns of ECOTECH-- as reinforcements to APEC’s resilience and capability in restoring stability and confidence to the region.

The APEC leaders underscored what they considered to be encouraging developments system in recent months that have resulted in “a substantial degree of financial stability.” They include “the progress made by Indonesia, Korea, Philippines and Thailand in the implementation of strong reform programmes, backed by an unprecedented degree of financial cooperation and support from the international community.”

In the economies that were cited, it was pointed out that exchange rates have remained relatively stable, and have strengthened in many of these economies over the past several months. Fiscal policies have been adjusted with support from international financial institutions to allow increased spending to support demand and employment. The initial acceleration in inflation that accompanied devaluation has been contained to moderate levels in most emerging Asian economies, and the rate of inflation is now decelerating across the region. Short-term external debt burdens have been reduced and reserves have begun to be replenished in many economies. Current account balances have moved into surplus, although most of the adjustments have come from reduced imports. Output declines have been more extensive than many had anticipated, but are now moderating.

The leaders also recognized progress in the priority areas of human resources development and harnessing technologies of the future, and the improvements in the management of the economic and technical cooperation process including the work underway in infrastructure and sustainable development. They instructed their ministers “to give further focus to strengthen coordination in ECOTECH activities

and intensify work in priority areas.” They exhorted the business and private sector in ECOTECH activities to assist in enhancing their efforts to advance the economic and technical cooperation agenda, especially citing ABAC’s commitment in this area through the Partnership for Equitable Growth (PEG).

The leaders of APEC welcomed Japan’s proposed financial package of US\$30 billion—the so-called Miyazawa Initiative. US\$15 billion of this support measure will be made available for the medium- to long-term financial needs for economic recovery efforts in Asia, and another US\$15 billion will be set aside for the short-term capital needs in the course of implementing reforms. They also commended the multilateral initiative to revitalize private sector growth announced by Japan and the US in conjunction with the Asian Development Bank and the World Bank. This initiative has four components: “(1) accelerating the pace of bank and corporate restructuring by removing impediments to the return of growth, (2) increased trade finance to give Asian companies greater access to funds they need to revive production and create jobs, (3) efforts to mobilize new private sector capital to help Asian companies rebuild their balance sheets and move forward quickly with restructuring so they can make new investments and grow again, and (4) enhanced technical assistance to help equip countries with the expertise they need to overcome the complex financial and corporate restructuring they face.” The Miyazawa initiative and the Japan-US-World Bank-ADB Initiative do not strictly fall within the ambit of ECOTECH as defined in APEC, but are indeed forms of economic cooperation addressed to the current financial crisis.

Economic and Technical Cooperation in APEC

The first ministerial meeting of APEC that was held in Canberra in 1989 identified areas of cooperation, including economic studies, trade liberalization, investment, technology transfer and human resource development, and sectoral cooperation” (APEC Secretariat, 1995). But it was in 1994 when development cooperation was clearly recognized as a major concern of APEC. Such a recognition was part of the member-economies’ goal of building a community. It has also served to alleviate apprehensions in some sectors that the APEC was solely concerned with trade and investment and was not sensitive to the issues of equity and environmental quality.

The priority given by the APEC economic leaders to development cooperation was formally expressed in their Declaration of Common Resolve which was signed in Bogor, Indonesia on 15 November, 1994. They acknowledged that development cooperation among member-economies “will enable us to develop more effectively the human and natural resources of the Asia-Pacific region so as to attain sustainable growth and equitable development of APEC economies, while reducing economic disparities among them, and improving the economic and social well-being of our people.” They stressed that it would also facilitate the growth of regional trade and investment.

At the Osaka summit in 1995, the APEC economic leaders committed to “promote action-oriented economic and technical cooperation in a wide range of areas.” They agreed to “work through policy dialogues and joint activities to broaden

and deepen intra-regional cooperation” in the various areas of economic and technical cooperation. By this time, the consensus was to use “economic and technical cooperation” instead of “development cooperation,” to avoid the perception that the traditional concept of development assistance will be adopted in APEC.

By 1995, the member-economies had decided that economic and technical cooperation will be conducted “on the basis of the principles of mutual respect and equality, mutual benefit and assistance, constructive and genuine partnership and consensus building” (Osaka Action Agenda, Part Two, Section A: Essential Elements). It was clearly stated that “APEC economies shall make voluntary contributions commensurate with their capabilities and the benefits of the cooperation shall be shared broadly.” In implementing ECOTECH, the member-economies committed themselves to developing an environment favorable to the effective operation of market mechanisms and integrate into the cooperation process the business/private sector as well as other pertinent institutions. Environmental considerations will be integrated in these joint activities.

The member-economies agreed on Common Policy Concepts, Joint Activities and Policy Dialogue as the three essential elements of each specific area of ECOTECH. The areas of joint activities include research, data and information sharing, surveys, training programs, seminars, technical demonstrations, exchange of experts, technology sharing and transfer, establishment of research and business networks, and many other undertakings that promote effective use of the region’s resources and increase the effectiveness of policy measures.

The Osaka Action Agenda comprised 13 specific fields of concern: human resource development, trade and investment data, trade promotion, industrial science and technology, energy, marine resource conservation, fisheries, telecommunication and information, transportation, tourism, small and medium enterprises, economic infrastructure, and agricultural technology.

In the APEC framework for Strengthening Economic Cooperation and Development which they adopted, the following were identified as the characteristics of APEC economic and technical cooperation: (1) It must be goal-oriented with explicit objectives, milestones and performance criteria; (2) It encourages the private and business sectors to participate in and initiate economic and technical cooperation activities in cooperation with government agencies; (3) It should draw on voluntary contributions commensurate with the capabilities of member economies; and (4) It should generate “direct and broadly shared benefits among APEC member economies to reduce economic disparities in the region” (APEC Framework , 1996: III, 3).

The economic leaders recognized that “economic and technical cooperation and trade and investment liberalization and facilities are mutually complementary and supportive.” They adopted the principle of mutual respect for the diverse situations and capabilities of member-economies.

The issues of equity and environment were given consideration in the Guiding Principles: “We emphasize the need to jointly undertake economic and technical cooperation activities that will promote the full participation of all men and women in the benefits of economic growth. In pursuing these activities, we shall be guided by

our responsibility in making economic growth consistent with environmental quality” (Ibid.: II, 2).

Economic and technical cooperation provides the human dimension of APEC. This is evident in its avowed goals: the attainment of sustainable growth and equitable development in the region, the reduction of economic disparities among APEC economies, the improvement of the economic and social well-being of the people, and to deepen the spirit of community in the Asia Pacific (Ibid.: I). These goals are consistent with the economic leaders’ declaration that “our vision of community can be strengthened only if our efforts benefit all citizens” (APEC Economic Leaders’ Declaration, 1996: Para. 16).

In order to provide focus and coherence to economic and technical cooperation activities, priority is given to the development of (a) human capital, (b) stable, safe and efficient capital markets, (c) economic infrastructure, (d) technologies for the future, (e) the quality of life through environmentally sound growth, and (f) small and medium enterprises (APEC Framework, IV).

Is ECOTECH the Adequate Response to the Crisis?

With the decline of ODA, the APEC mechanism of ECOTECH may fill the gap in the area of development financing. Foreign-aid flows to developing countries are expected to decline in the near future. The OECD Development Assistance Committee (1996) reports that donor countries have made sharp cuts in their aid budgets. Official development assistance (ODA) dropped by 14% in real terms between 1992 and 1995. The prospects of continued aid flow for development are not bright, as increasingly larger portions of total ODA are being channeled to fund emergency relief and peacekeeping activities at the expense of financing long-term development needs. This trend reinforces the argument that donors are losing confidence in the effectiveness of aid (Manzano and Villacorta, 1997).

The APEC approach to development cooperation departs from the traditional concept of foreign aid or ODA in theory and in practice. It lays stress on pooling of resources -- be it in experience, expertise, information, technology or financial transfers. It upholds equality and mutual respect and enhances commitment or ownership of proponents through the consensus and participatory approach. Thus, it avoids, by design, the one-way relationship that characterizes the traditional form of development cooperation.

ECOTECH can contribute towards enhancing institutional capacities and the policy investments of the member economies. This can only lead to greater absorptive capacity to ODA. Especially in an era where foreign aid is linked with country performance, ECOTECH has much to contribute to making APEC member countries attractive to sources of capital - both ODA and private money. The ultimate agenda of ECOTECH, however, is to act as a catalyst to hasten the graduation of member economies from aid recipients to integrated participants in the world market (Ibid.).

ECOTECH can assist in weaning the relatively poorer APEC member-economies away from foreign aid and introducing them to world capital markets.

ECOTECH also involves activities that promote the integration of the private sector in the cooperation process. The driving force in the economic growth of developing economies is for the most part attributed to private-sector initiatives. Since this sector operates best in a market environment, it is important for the APEC type of development cooperation to be market-friendly. What this means is that development cooperation should be non-distortionary. This has implications on capital markets and public goods. In the past, a large portion of foreign aid is spent on public goods like infrastructures. Because of the long gestation and the difficulty of appropriating the benefits, these projects are usually shunned by the private sector. However, as recent experience shows, infrastructure provision and financing, previously supplied by governments, can already be supplied efficiently by the private sector if governments provide the right policy or regulatory environment. Besides credit-worthiness and political factors, the constraint faced by some developing member-economies in embarking on this new scheme is the lack of experience in managing these approaches. By sharing experiences, best practices and policy dialogues, ECOTECH activities can help less-developed member-economies take advantage of private-sector resources for financing developmental projects. It is in this catalyst role that ECOTECH activities hold great promise to member-economies. ECOTECH activities should aim at facilitating the “graduation” of less-developed member-economies from foreign aid and their entry to international capital markets (cf. McCawley, 1998:43).

Given the urgency of the financial crisis, APEC should implement at an accelerated pace ECOTECH measures that focus on improving the financial capability of the developing economies. This imperative was recognized by the APEC leaders in the Vancouver summit last year. They called for exploring ways of intensifying APEC’s economic and technical cooperation “giving priority to upgrading financial systems, enhancing cooperation among market regulators and supervisors and other measures to help improve the integrity and functioning of financial markets.” This call was repeated by the leaders in Kuala Lumpur who emphasized “capacity building” and stressed that “economic and technical cooperation has acquired added urgency in the wake of the financial crisis.” Their senior officials who also met in Kuala Lumpur reaffirmed the importance of ECOTECH activities “to strengthen economic fundamentals.” They reiterated the six priority areas for reducing the economic disparity among APEC member-economies: “developing human resources; developing sound, safe and efficient capital markets; strengthening economic infrastructure; harnessing technologies for the future; safeguarding the quality of life through environmentally sound growth; and strengthening the dynamism of small and medium enterprises.” Due to the financial crisis, ECOTECH, the least appreciated pillar of APEC, is finally accorded the importance that it deserves.

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