

## The Outlook for Asia and Other Emerging Markets in 2000<sup>1</sup>

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It has been two years since my last visit to Korea. At that time, Korea was just launching its wide-range economic reform program. I expressed confidence that with firm pursuit and implementation of this program, Korea would recover and reestablish the momentum that had characterized economic growth here for over three decades. Now, it is clear that the Korean economy is back. I must admit even I had been somewhat surprised at the strength and the forcefulness of the turnaround. I believe this reflects a number of important factors, but we must all express admiration and commendation for the remarkable leadership demonstrated by the government of President Kim. Indeed, the perseverance and determination that we have seen in implementation of sound macroeconomic policies and advancement of key structural reforms have been remarkable. The Institute for International Finance monitors emerging market economies around the world. And I can think of none among the total 55 economies we cover that has accomplished as much in fundamental reform and restructuring as you have in Korea in the last two years.

I would like to now mention the broader dimensions of revitalization throughout Asia. I also want to highlight some of the key challenges that lie ahead. As recovery takes hold, investments rebound, and Korea benefits from strong export performances, it is important that macroeconomic policy gradually recedes from its roles as an economic stimulus and that the process of fiscal consolidation continues. It would be important for fiscal and monetary policies to recede even further as dynamics of market-based reforms begin to lead and sustain economic expansion in this country.

Given the current difficulties still being addressed in Daewoo and in other areas, Korea has understandable concerns regarding the level of long-term interest rates and further appreciation of the won. If the won should appreciate much more and rather more quickly, this could signal a new obstacle in Korea's economic outlook. Of course, it is natural that there are some upward pressures on the won.

I believe that Korea is somewhat fortunate that its competitor and neighbor to the south, Japan, is also facing continued strong upward pressures on its currency. And I believe this is likely to continue, although the G7 meeting in Japan this week may attempt to signal some concern about the further appreciation of the yen. As this government continues to pursue a sound macroeconomic policy and provide a framework for macroeconomic stability, it would be important to sustain low inflation as the economic expansion continues. It would be equally important for Korea not to lose any energy and momentum in the fundamental process of structural reform and liberalization in its economy.

In spite of the tremendous progress made, there are long-standing practices and attitudes that are not going to help change Seoul. And if the leaders in the business and finance communities and the government are not careful, forces of complacency can reappear, perhaps with even more vigor than we now anticipate.

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Challenges facing Korea include: the continued reform of the chaebols; implementing global standards of disclosure, transparency, and corporate governance; development of a new generation of skilled bankers, who not only have addressed the problems of the past by cleaning up their balance sheets, but are prepared to manage their financial institutions going forward with the highest standards of risk management and transparency; the continued liberalization of Korea's trade regime, where dramatic progress has been made; continued encouragement of the flow of foreign capital that can stimulate and leverage the innovative forces already in Korea's economy; and addressing remaining problems in the trust financial institutions and in the insurance sector. These are all challenges that continue to lie ahead. I hope that as the government, business and financial communities tackle these problems. It will be possible for the government to gradually provide a framework for progress. I still sense that the government tends to be highly directive with regard to some particular pieces of reform. Gradually, this will need to be taken over by market-based signals and pressures for reform. We see this happening, but it will be very important that the government, the business and financial community understand the need for this evolution as recovery continues. None of my discussions about the challenges ahead, in any way, can detract from the dramatic progress that has already been realized in Korea.

However, nothing in today's global economy can be taken for granted, not the Japanese recovery or the U.S.' continued expansion. We live in such a globalized economic and financial system that it is very difficult for us to know from where the next problem may arise. Will Argentina falter this year in its efforts to tackle the large fiscal deficit or will it have difficulty servicing and meeting the requirements to raise new capital to service old debts? If there should be problems in Latin America, will the problems spill back into Asia? And if so, how will it lead to a so-called "soft landing"? Will we have another period of exchange rates instability among the major currencies, which could complicate greatly the life in Korea or Thailand, or will it spill back into Asia? Will the U.S. economy continue to expand robustly or is it following in the same path as many emerging markets in Asia?

I think we do recognize that we live in a world of uncertainty and because of this, we must take matters into our own hands. I think Korea has demonstrated the capacity to do that. But in order to move up a level in the global economy, I believe the continuation and deepening of the reforms are going to be essential. It is becoming a remarkably competitive world and the past formulas that worked in Korea -strong export performance based on controlled and somewhat closed domestic markets- will not be successful in the future.

I believe that the year began with some momentum in other surrounding countries as well. You cannot expect the lift-off of the Japanese economy to be very strong nor to be very rapid. However, Japan has a government that is actually losing energy in encouraging economic reform. Just as Korea faces elections this year, so does Japan. Maintaining discipline and reform in the face of elections is one of the most challenging dimensions of any democratic country. And yet, we see how critical it is to maintain the momentum of reform. Japan has recently postponed a couple of key measures, which raised concerns and questions about Japan's commitment for reforming its financial markets and economy.

In rest of Asia, we take some encouragement from the continued expansion in China and by the courage it has demonstrated in subjecting its economy to the global forces of competition through membership in the WTO. I have little doubt that this will generate substantial

pressures on the inefficient parastatal of China-- pressures on the corporate and financial sector. But, this is the way forward and we will continue our interest in China's efforts to restructure its economy in this globalized world.

We are also somewhat encouraged by the reform efforts and the economic recovery under way in the Philippines, Thailand and Hong Kong. Then again, current rate of growth of five percent we anticipate in Thailand and Malaysia are not likely to be sustained, if the reform efforts are thwarted. We are somewhat concerned about the need for strong leadership in Indonesia and for political evolution in countries such as Malaysia.

Looking globally, we believe that capital flows to emerging markets are being revived this year, hopefully on a more prudent basis than before. Looking back on the last decade, we see that while weakness in economic policy was at the core of the crisis that struck Korea, Thailand and Indonesia, imprudent lending policies by leading global financial institutions, including many members of my own institute, contributed significantly to the severity and volatility of the crisis. For some period, capital flows into emerging markets have been mostly equity flows. Last year, total net private capital flows to all emerging markets around the world were in the range of one hundred-forty billion dollars. This compares to over three hundred billion at the peak in 1996 and an average of over two hundred billion over the last six years. The troubling part of the equation was that there were no net debt flows into emerging markets at all. The total sum of net commercial banking and net capital flows into emerging markets in 1998 and 1999 are the same: zero. This is not sustainable and as Korea, Thailand and other economies in the region recover, gradual access to debt and equity financing is needed.

Don't get me wrong, I applaud the surge of equity flows into Korea; it is long over due. I believe it will help reinforce the dynamics of competition and competitiveness throughout the regional economies. We will need to see a restoration of some lending in global capital markets and not just among the G10. We are beginning to see some restoration this year, but it is still tentative. Indeed, we anticipate that western commercial banks going back into the emerging markets of Asia will still be only in a neutral position. Of course, some of this has a positive dimension: early prepayment by Korean borrowers to their creditors, for example, is a positive sign and it reflects in the aggregate numbers as negative lending. But it would be important to rebuild confidence among the lenders, banks and capital markets. This is another reason why steady implementations of policies are critical. We anticipate that net capital flows to all emerging markets will grow this year from the range of one hundred forty billion to one hundred ninety billion. However, there are still considerable hesitations among asset management firms, institutional investors, insurance companies and pension funds when it comes to putting large amounts back into emerging markets.

I believe that both the Korean government and institutions like the IGE should play increasing roles in the debate over global financial architecture. We, at our institute, have been very active, with over one hundred different financial institutions contributing to a series of reports last year. The purpose of the reports was to make the private sector realize the need to take lessons from the last couple of years seriously and also to engage in a serious dialogue with the private sector, with emphasis on two areas: how to avoid a repetition of crises and how to cope with them when they do arise. I believe that Korea has made progress not only in macroeconomic and structural areas, but also in advancing macroeconomic and corporate transparency and in developing systemic set of relations with Korea's investors. The new Minister of Finance and Economy is making progress establishing an office within the ministry

to continue interfacing with the global investors and creditor community. Had there been this kind of dialogue and mutual understanding when Korea encountered problems in the fall of 1997, I believe the severity of the crisis would have been much less. However, both lenders and borrowers have the tendency to care only about the next deal when things are going smoothly.

We have just released a new assessment about how well the 27 leading emerging market economies are doing in their macroeconomic transparency, and I am very pleased to say that Korea ranks relatively high on the list. I would also say, however, that as important as it is to position ourselves to avoid and cope with crisis, we must have better plans in place to manage them when crises arise. And here, I believe the progress is not too great. I am encouraged by the creation of the new group, G-20, which does include Korean representatives, which I think is a step toward reality: for too long, Korea has been under-represented in places like the IMF and the World Bank. This will give Korea a seat at the table, but Korea must exercise its voice and participate actively in the debates. Right now, there is a lot of debate about “bailing-in” the private sector, involving the private sector in crises, and the need to pursue involuntary approaches. As you can imagine, we, at the institute representing private financial institutions, do recognize the need for these private financial institutions to accept the consequences of their lending decisions and not to be bailed out by local governments, central banks or multilateral institutions. At the same time, for the IMF, G-7, or G-20 to believe that the solution to every crisis is requiring banks and bondholders to automatically reschedule their debt, is not a very productive approach. A consultative cooperative approach that was taken with regard to the short-term debt of Korea a few years ago stands as a clear example of how private financial institutions and governments can work together. But even that approach was implemented almost too late. We need to have early dialogue between the private financial institutions and the IMF anytime there is a potential serious problem on the horizon, whether it is Russia, some country in Latin America, or a country in Asia, to consider market based techniques case by case and to encourage private financial institutions to participate in the economic adjustment problems in difficult situations in difficult countries. Today, there are smaller cases around the world, much smaller than the Korean economy and much less important to the global economy, which nevertheless have brought implications because some investors have reservations about how the IMF is going to treat smaller emerging economies.

We look forward to continuing and deepening the dialogue with the government and we hope to do so with a growing involvement of the new banking establishment in Korea. One of my purposes of visiting Korea is to see leading executives to encourage them to become involved in the activities of the IIF and to benefit from the discussion and pursuit we have of global standards of banking in the world. I believe that one of new dimensions of Korea’s reformed economy should be a banking system of global standards. It does not mean American standard, or western standard; it means global standards of transparency, accounting, and risk management and capital adequacy. I believe that the Korean financial community is now well positioned to do just that.

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## Q & A SESSION

**Q:** First, what do you think of the recent trend of non-deliverable forward transactions in Korea, as well as, the region? Second, what would be the KOSDAQ’s role in Korea’s reform on chaebols, i.e., transparency? Lastly, the liberalization and deregulation of Latin American

emerging countries, especially Chile and Venezuela seem too rapid. Will these two countries face difficulties in accommodating the too-rapid deregulation in such a none too democratic political environment?

**A:** On Latin American liberalization, I don't believe that the change of government in Chile or Venezuela will lead to excessive liberalization in these economies. Indeed, I am rather confident that we will not see a dramatic change in the economic policies of Chile as a result of this election. I believe that it is an encouraging sign that the recent elections in Latin America have been conducted rather peacefully.

In Venezuela, the situation is rather different: it is not just a leftist government but also a very populist government, which is undermining confidence among both international and domestic investors. One can only hope that there is a turn toward a more practical set of economic and political policies in Venezuela because the current course, in my view, is indeed troublesome, somewhat obscured by the high oil prices.

With regard to Korea's exchanges in KOSDAQ and the evolution of chaebols, I think it is healthy to see the growth of new exchanges and to see the competition between exchanges that can foster greater transparency, greater corporate disclosure, quarterly reporting. Korea has remarkable potential to be at the front edge of global technology development and I believe that KOSDAQ can play a role in this process.

With regards to non-deliverable forwards, I believe that the leaders in central banks should be very careful about how they deal with these issues and not assume that you can easily manipulate exchange rates in today's market-based economy. Korea should be very transparent about what is being done here because lack of transparency was the key issue in lack of confidence in past crises.