Lee Hsien Loong: ASEAN post-crisis - rebuilding confidence and prosperity

Speech by Mr Lee Hsien Loong, Deputy Prime Minister of Singapore and Chairman of the Monetary Authority of Singapore, at the Bank of Thailand, Bangkok, 30 November 2000.

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Distinguished Guests, Ladies and Gentlemen,

Introduction

I am honoured to be here today to deliver this lecture organised by the Bank of Thailand in conjunction with the 72nd birthday celebrations of His Majesty the King. On this joyous occasion, on behalf of Singapore and its citizens, I wish His Majesty good health and many happy returns of the day.

The topic of my talk today is, “ASEAN post-crisis: rebuilding confidence and prosperity”. The Asian crisis is past, but its consequences are still with us. I propose to review the post-crisis environment which ASEAN faces today, and discuss some of the lessons to be drawn from the crisis. Then I will focus on what ASEAN and its member countries should do to restore confidence, long-term growth and prosperity in the region.

Passing of the crisis

The financial crisis swept through ASEAN economies like a tidal wave. Between 1997-99, the combined GDP of the original five ASEAN members fell about one-fifth, in US$ terms. Unemployment rose, businesses folded, and governments and societies came under stress.

Three years after the crisis struck, the region is stabilising. The worst passed much sooner than many expected. The recovery initially depended on expansionary fiscal policies, and strong exports especially of electronics products. But it has now broadened. Intra-regional trade is buoyant. In most countries, consumer spending has rebounded, and private investment has picked up.

Challenging conditions remain

The recovery has given the Asian economies breathing space to tackle the problems uncovered by the crisis. But these problems have not gone away. Post-crisis ASEAN faces major challenges. North East Asia seems to be doing better than South East Asia. And continuing political and economic difficulties in South East Asia, plus the perceived weakness of ASEAN as an organisation, are strongly colouring the views of analysts and investors.

North East Asia

The thaw in relations between North and South Korea bodes well for North East Asia. South Korea, one of the crisis countries, has recovered quickly and strongly. Under President Kim Dae Jung, the government pushed hard for economic reforms, restructuring the chaebols and cleaning up the banking sector. Last year South Korea recorded the fastest growth in Asia - 10.7%.

South Korea’s reforms are now running into difficulties. The actual task of breaking up and selling off pieces of the chaebols is encountering stiff union resistance. But North East Asia continues to attract interest. Other than South Korea, another major reason is China.

China has weathered the economic crisis much better than many analysts had expected. Its economy slowed down but did not falter, and is now growing strongly again. China is continuing with its economic reforms, improving its investment environment and offering attractive long term opportunities for investors.

China's imminent entry into the WTO is a major plus for China's economic development. Asia will benefit from China's continued stability and prosperity. But China's entry will also mean stronger competition for ASEAN countries, particularly those which depend on labour intensive industries. ASEAN's exports will be affected, as will its foreign direct investments.

South East Asia

In South East Asia, many countries are still tackling economic and political issues. Economically, the broad view is that progress in reforming the banking and corporate sectors has been slow, causing the region to remain vulnerable to any softening of external demand.

Politically, Indonesia is in the midst of a wrenching transition, with the final resolution still unclear. In the Philippines, the political unrest and now the impeachment and trial of President Estrada has affected the peso, the stock market, and the economy. In Malaysia, UMNO is striving hard to win back the Malay ground, and is fending off a strong challenge from PAS, the opposition Islamic party. Thailand is preparing for general elections.

ASEAN

The crisis has also raised doubts about ASEAN's credibility and relevance as a regional organisation. ASEAN appeared divided and slow in responding to the crisis, and even now is seen as weakened and drifting.

The expansion of ASEAN to 10 members has made it harder for the organisation to maintain focus and reach consensus. From a long term geopolitical perspective, this expansion is crucial for ASEAN's strength. But in the short term it has added to doubts about ASEAN's viability.

Regional and international journals have portrayed ASEAN as drifting apart. Analysts doubt whether ASEAN countries can get together to pursue economic cooperation, lower trade barriers and restore prosperity and confidence. As one analyst said on BBC TV:

> "A lot of these issues are more or less on hold. … there's very little impetus for really substantial change in the past few years and ASEAN hasn't coped well with the various political and economic crises that the region has seen.
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> If you look at investment, it's really shifted to Korea, to China and it's going to probably get much more competitive when China joins the WTO. In many ways, a lot of Southeast Asia has lost its competitive edge. The political problems, economic problems have really hurt the region. So, what you are seeing now is a lot of investors really reassessing their view of this region and moving much more towards the north east of Asia."[1]

Falling behind

The figures confirm this. Since 1996, Foreign Direct Investments (FDIs) to the North have continued to rise, whereas FDIs to the South have fallen to about half pre-crisis levels. As a result, Southeast Asia's share of total FDIs to East Asia (excluding Japan) halved, from 33% in 1996 to just 15% in 1999.

In equity markets, Southeast Asia's weight has declined, while Northeast Asia's has increased. Before the crisis, Southeast Asian markets had more than twice the weight of Northeast Asian markets

[1] Robert Templer of Strategic Intelligence, interviewed on Asia Business Report, BBC TV, 22 November 2000.

(excluding Japan) in Morgan Stanley's MSCI Asia Free index. Now the position has been totally reversed.

Lessons from the crisis

ASEAN countries must not allow this situation to continue. They should strengthen themselves individually, and also work together to sustain their long-term prosperity. Then they can dispel the perception of a region in distress, restore confidence and get on the move again.

Sound fundamentals

What lessons should ASEAN countries draw from the crisis? First, that despite the upheaval, the transformation of East Asia over the last two decades was no mirage. The Asian miracle was real - the halving of poverty rates, the dramatic improvement in living standards, literacy and health standards, and the modernisation of the economies. Asia's prolonged boom had been underpinned by sound economic fundamentals. These remain a vital positive factor, which can help ASEAN to prosper again.

However, many economies had significant structural weaknesses. Financial regulation and supervision were weak, transparency was lacking, and there were serious shortcomings in governance and public administration. "KKN" - the Indonesian acronym for corruption, collusion, and nepotism - was often a problem. These weaknesses may or may not have caused the crisis, but they certainly contributed to its severity. The weaknesses must be resolutely tackled, otherwise even if economic growth resumes, the fundamental problems and vulnerabilities will remain.

Capital account risks

Second, the crisis exposed the risks of opening up capital accounts prematurely. A free flow of capital can provide countries with much needed funds to develop their economies. But countries have to liberalise their capital regimes in step with the strengthening of their domestic economy and institutions. If they open up before their corporate sectors and financial systems are ready, they run the risk of being swamped by volatile capital flows, both inwards as well as outwards.

Bank financing risks

Third, the crisis highlighted the dangers of relying too heavily on bank financing. Capital markets in most ASEAN countries are relatively under-developed. Before the crisis, many firms borrowed short-term in foreign currencies, in order to finance long-term projects earning revenues denominated in local currencies. These mismatches exposed the borrowers, the lenders, and the entire system to considerable risks. When the crisis struck and currencies plunged, there was a vicious spiral. Businesses were saddled with a massive increase in debt burden from their foreign currency debts, and ran into difficulties. This got the banks into trouble, which, in turn, left firms with no alternative avenues to raise working capital to stay afloat. Countries therefore need to develop their capital markets, so as to diversify their sources of funding and reduce their dependence on bank lending.

The international financial system

Beyond these domestic factors, the crisis has also uncovered weaknesses in the international financial system, and raised questions about the roles of the IMF and World Bank. Several international groups are examining these issues. They have made useful proposals and recommendations to improve aspects of the global financial architecture, although some issues still remain contentious, such as how to regulate hedge funds. The task now is to implement without delay those reforms on which broad consensus has been reached. The reforms will not prevent all future crises or mishaps. However, they should make financial systems, especially in emerging markets, more robust and less vulnerable to contagion effects when the next crisis strikes.

Rebuilding confidence and prosperity

Given these conclusions, what should ASEAN do to rebuild investor confidence and achieve prosperity?

Accepting globalisation

First, countries have to accept that globalisation is a reality. They should take advantage of globalisation, and not fight against it. It is a powerful trend that can bring benefits to their people. Before the crisis, ASEAN had prospered by riding the wave of globalisation. Their take off had been fuelled by strong investments by MNCs, buoyant exports and freer trade and economic policies. Within ASEAN, the most open economies were also the fastest growing, whereas isolation led to stagnation.

Against this backdrop, the crisis came as a profound shock, which could easily have caused a backlash against globalisation. Had countries turned their backs on foreign investments and exports, it would have impoverished them and weakened the region. Fortunately this has not happened.

There have been understandable nationalistic sentiments against selling distressed companies at low prices to foreigners. But all ASEAN countries continue to seek foreign investments and trade. Their people are eager to learn English, and to exploit the internet. They know that plugging into the global economy is still the best way to sustain growth, and to create jobs and prosperity for their citizens. They also know that competition has become keener, and that they have to make their economies more attractive to foreign investments. As Malaysian Finance Minister Daim Zainuddin acknowledged in his recent Budget speech:

> "In a borderless world, large international conglomerates have greater choices in their investment decisions."

Accepting globalisation means progressively deregulating and liberalising ASEAN economies, easing rules on foreign ownership and participation, and opening up hitherto protected sectors. By exposing their economies to the winds of change and the pressures of global competition, countries will strengthen their own players, who will learn to hold their own without crutches or protection.

Of course the process has to be managed. Sudden deregulation of a controlled economy may lead to chaos and collapse, as happened in Indonesia in 1998, when the IMF pressed the Suharto government to dismantle everything overnight. But properly implemented, opening up will lead to substantial long term benefits and prosperity, despite the short term social and economic costs.

Globalisation does not mean that ASEAN countries should allow themselves to be swamped by foreign companies. It is a legitimate ambition for countries to want to build up their own strong companies. But the companies need to be internationally competitive; it is not viable for them to depend on protected home markets. Companies which cannot hold their own domestically will find it very difficult to compete abroad.

Furthermore, governments must understand what industries they have the best chance of building up, given the nature of the global marketplace. In many industries technology and economies of scale have led to a worldwide wave of mergers and consolidations. For example in banking and auto manufacturing the scale has become global, with a few large players dominating the worldwide market. In these industries, the most promising approach for small and medium countries is to seek investments from these major players, not to build up their own national champions to compete against the giants. This is what Thailand has done with the auto industry.

Globalisation has its downside. The competition is intense, the environment is constantly and rapidly changing, restructuring and upgrading are endless tasks, and unpredictable disasters strike from time to time. All this brings disorientation, new insecurities, and a sense of loss of control. But governments have to manage these problems and risks. They need to cushion the social impact of globalisation, to help industries that are no longer viable make the change, to equip the population with the necessary skills for the new economy, and to provide a social safety net for those at the bottom. There is no real alternative to accepting globalisation in order to improve the lives of our people.

ASEAN economic cooperation

It is also important for ASEAN countries to work together, both to strengthen cooperation among themselves, and to address international issues of common concern to all of us.

ASEAN economic cooperation was progressively gaining momentum before the crisis. Major initiatives had been launched, especially the ASEAN Free Trade Area (AFTA) and the ASEAN Investment Area (AIA). These promised to increase significantly the flow of trade and investments among ASEAN countries.

However the crisis has caused some countries to hold back, in order to give struggling domestic industries more breathing space. These pressures are real, but in their anxiety to protect individual industries, countries should not lose sight of the wider benefits of ASEAN cooperation to their economies as a whole.

It is therefore important for ASEAN members to reaffirm their commitment to regional economic cooperation and integration, and implement AFTA and the ASEAN Investment Area in letter and spirit. The ASEAN members which are doing relatively better, such as Thailand, Malaysia, Singapore and Brunei, should take the lead, and work together to put ASEAN cooperation on track again.

At last week's 4th ASEAN Informal Summit in Singapore, ASEAN leaders launched an Initiative for ASEAN Integration or "IAI". It is intended to narrow the divide between the older and newer members of ASEAN and enhance ASEAN's competitiveness as a region. It is a framework for the more developed ASEAN members to help those members that most need help, and in so doing make ASEAN prosper. To kick it off, Singapore is offering a package of IT training and assistance in human resource development to Myanmar, Laos, Cambodia and Vietnam, while China, Japan and South Korea have also offered assistance that falls within IAI's broad framework.

Of course, ASEAN's future depends as much on external factors as it does on these direct initiatives to promote intra-ASEAN trade and investment, and build up the economic strength of individual members. Our economies are highly dependent on international trade, and it is in our interest to work together actively for a freer, more stable and secure global trading environment.

ASEAN therefore needs to support an open, stable multilateral trading system under the WTO, and the early launch of a new round of trade negotiations. Strong multilateral rules are the foundation for world trade, and protection against anarchic bilateral and unilateral trade policies. Small countries could not survive without them; even large economies would be much poorer off in a tit-for-tat environment. Hence ASEAN strongly supported the candidacy of Dr Supachai Panitchpakdi for the Director Generalship of the WTO.

Besides the WTO, ASEAN and its members need to take full advantage of APEC, supporting its concept of "open regionalism", and its goal of free trade and investment in the Asia Pacific region. ASEAN also needs to explore links with other regional groups, for example with North East Asia through a possible free trade area with China, Japan and South Korea. At the Informal Summit, the ASEAN plus three countries clearly recognised that it is not in their own interest for the divide between Northeast and Southeast Asia to continue widening. The "plus three countries" want to work with ASEAN, to develop closer and deeper linkages between the two sub-regions.

The way to strengthen ASEAN economic cooperation is by participating actively in these external fora, and not by opting out of them. This will send a strong signal to the world that ASEAN remains an open and outward looking organisation, with its members welcoming competition and strengthening themselves as a group. It will help restore ASEAN's credibility as a vigorous and effective organisation that plays a responsible, relevant role on the international stage.

Corporate sector restructuring

The third area on which the crisis countries have to focus attention is their corporate sectors. Insolvent and non-viable companies have to be restructured, to set growth on a firm basis and restore confidence. The problems differ from country to country, but some fundamental issues are common.

First, the huge outstanding debt owed by the corporate sector must be resolved, as cleanly and expeditiously as possible. Governments need to step in to push the process through, and in extremis to take over insolvent firms and do the clean-up themselves. Clear and enforceable bankruptcy laws are needed to deter prolonged default by debtors, and give creditors incentives to settle. And for the future, there must be more transparency in terms of corporate governance and reporting.

For example, Thailand passed new bankruptcy and foreclosure laws last year, and I understand has just passed a new Accounting Act. Among other things, the new laws will stipulate minimum qualifications for auditors, and ensure that directors take greater responsibility for the accuracy of financial statements. Investors and analysts will view these steps positively, especially if foreclosure cases brought under the new laws and now before the courts are fairly and speedily settled.

Second, many private sector firms, particularly family-owned companies, need to upgrade and modernise their management.

Family businesses and conglomerates are a feature of many Asian economies. These were built up through the business acumen and drive of their founders, and still account for a sizeable component of the economies.

But the world has changed. Capability and competence are now at a premium, and relationships count for less. Family companies need to segregate clearly ownership rights and management functions, and bring in other significant shareholders and external capital. Their challenge is to evolve into modern corporations that are more than family companies. They need to be run professionally by the best man for the job, and not by heirs who may or may not have inherited the business skills and acumen of the founder.

Third, governments need to untangle the complicated and deeply-entrenched ties between state, banks and industry, which exist in many Asian countries, like the chaebols in South Korea, or the state-owned enterprises in China. Such industries and enterprises often account for a significant share of GDP, but they are neither subject to market discipline, nor driven purely by economic considerations. They often find it difficult to operate as efficiently as private sector firms. Banks fail to apply normal criteria in approving loans, because of political pressure or implicit state guarantees. Employees enjoy de facto life-time job security. Well-connected persons help themselves to privileges at the companies' expense. And governments find it politically impossible to close down the operations, no matter how unsuccessful.

It is essential to speed up restructuring and reforming these unproductive enterprises. In China, the government is making a massive effort to reform its SOEs. In South Korea President Kim Dae Jung is pushing chaebols to rationalise and consolidate, and change their traditional ways of doing business. ASEAN countries must not lag behind, or else it will affect confidence in their investment climate.

Banking sector reforms

Besides pursuing corporate restructuring, ASEAN economies must persevere to clean up and recapitalise unsound banks, and strengthen the banking sector. Banks play a critical role in every economy. For ASEAN economies to continue to grow, they will need new investments. These investments will require financing, by sound banks able and willing to lend to sound borrowers.

The immediate priority is to speed up the resolution of the non-performing loans (NPL) within the banking system. The process is underway, but is far from complete. Even today, NPLs in some ASEAN countries remain well above 20%. As in the case of corporate restructuring, effective bankruptcy laws are essential. Asset Management Companies (AMCs) need sufficient power to deal expeditiously with debts which are unrecoverable. Otherwise the banking problems will infect the whole economy, and drag countries into the same deep-seated malaise as Japan.

Finding new money and writing off bad loans is the relatively easy part. It is more difficult, but equally important, for banks to put in place proper systems, structures, and prudential standards, to prevent the same problem from happening again. They need to establish rigorous credit cultures. They must lend based not on personal relationships, but on objective assessments of the borrowers' creditworthiness.

Many countries are encouraging bank mergers and consolidation as part of their plans to strengthen the financial sector. Mergers can help to strengthen the commercial banks, and give them the scale to compete in the globalised financial industry. However, mergers by themselves are insufficient. Unless mergers are accompanied by other measures to improve corporate governance, we will merely create one large weak bank out of several small weak ones.

Financial sector reforms also have to include strengthening of the supervisory system and institutions. Had supervision been adequate in the first place, the problems would not have become so grave. Professional and independent supervisory authorities will tighten standards of acceptable banking practices, and over time instil rigour and rectitude among all participants in the system. The supervisors have to set standards, penalise errant lenders, and remove implicit guarantees. Credit discipline will foster the emergence of stronger companies, and provide the basis for sustained growth.

Political and social preconditions

All these policies - accepting globalisation, fostering ASEAN economic cooperation, restructuring the corporate sector, and reforming the banking sector - are essential for countries to recover. But to be in a position to implement and make such economic policies work, countries must first create the right political and social preconditions.

Investors, both domestic and foreign, will adopt a wait-and-see attitude until they know how political uncertainties are resolved. Their views are coloured by past experiences, and they will look for evidence of a clear break with the past.

A stable political climate is essential to foster confidence, investment and growth. Governments must put their houses in order, bring corruption under control, and install men and women of integrity and competence to key positions within the top leadership. As Mr Anand Panyarachun, former Prime Minister of Thailand and now President of the Thai chapter of Transparency International, said:

> "The very basis of a non-corrupt culture is integrity. … It is a state of mind, an attitude. You can be corrupt without taking any money."[2]

The values, norms and business environment of ASEAN countries cannot be transformed overnight. It is more than enacting new laws and regulations. It means changing deeply established social relationships and norms which vary from country to country. Businessmen, civil servants and politicians used to operating in one way for years will not suddenly abandon or condemn old practices as soon as a new law is passed. Mom Rachawong Chatu Mongol Sonakul put it aptly:

> "What we are doing is a very long process. We're not talking of months or years. We are talking in, maybe, decades or generations. We're not changing our way of working. We actually try to change our way of life."[3]

These are matters that each country has to resolve for itself, in its own way. External inputs can be helpful, but may also be counter-productive. For example in Indonesia the IMF sought drastic economic reforms, which inevitably had far-reaching political implications. The result was a complete collapse of the Suharto government. But creating a new order to follow this is now a challenge which only Indonesia's people and leaders can resolve. Foreign advice and assistance now play only a secondary role.

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[2] Asiaweek, 3 November 2000.

[3] Keynote address during a seminar organised jointly by the Bank of Thailand and the World Bank entitled "Good Governance for Financial Institutions" on 10 June 2000.

There are, therefore, no one-size-fits-all solutions. Each country will have to pick up from the experiences of others, and adapt these experiences to their own conditions. Each will have to judge for itself the right balance and speed of changes to suit its own needs and circumstances. Nobody else has the same stake in the outcome.

Conclusion

The crisis has been a major setback for ASEAN and its member economies. Many external observers and investors still consider our economic prospects doubtful, and see ASEAN as an ineffective sunset organisation. These perceptions are political facts which can define political reality. If ASEAN economies do not deliver by way of structural reforms and strong, sustained economic recovery, and North East Asia continues to pull ahead, international investors will relegate us to the sidelines, and we will be marginalised.

Perceptions, however, can be proved wrong. The best answer to them is real action and change. We must strengthen our economies and make ourselves more competitive, while safeguarding ourselves against external shocks. We must press on with economic cooperation among ourselves, and with the rest of the world. And each country must set its own house in order, by creating the political preconditions, restructuring its corporate sector, and reforming its banking system. Then the resilience of individual members will result in a strengthened ASEAN as a whole.

ASEAN and its members have overcome many difficult challenges over the past three decades. Despite the crisis, we are much better off today than we were before the economic take off. The road ahead is indeed difficult. But the ingredients which fuelled our rapid growth in the past are all still there. Given the political will and the right policies, I am confident that in time ASEAN will recapture the lost ground, and thrive and prosper into the new century.