

Asia After The Crisis: Recovery and Reform

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Abstract: The lessons that can be drawn from the recent experience of East Asian economies appear to reinforce the argument that places the importance of market strengthening and government systems in the sustainability of economic recovery for which there are no short cuts. There a few key principles to keep in mind when we look at reform so that 10 years from now Asia does not find itself revisiting the unlearned lessons of 1997. The first is the practice of prudence and the concern for account- ability. Also it is important that the human element of this endeavour not be overlooked. Despite what some economists may say about the functioning of markets, social justice must remain one of the main purposes of govern- ments. And, constitutionalism which provides institutional reliability and accountability upon which sustained development depends.

Key words: reform; constitutionalism; accountability; social justice

Introduction

It is indeed a great honor for me to be invited to give this lecture. Herb Feith's legacy stretches far beyond the walls of academia, having been a man who turned principle into action and thought into practice, leading gene- rations of students, myself included, to share his passionate concern for human rights, peace studies and conflict resolution. I still take pride in the fact that when I spent a few semesters teaching a course on Islam and poli- tics in Southeast Asia at Georgetown University some years ago, Herb's books and articles featured prominently on my syllabus.

So much has already been said about the United States subprime crisis and its fallout that any further attempt would appear to be nothing short of trying to reinvent the wheel. Nevertheless as there are many ways to skin a cat, let me once again assail your ears with a tale of man's unbound greed, the unlimited wants of Wall Street's movers and shakers, and risk taking of colossal proportions. This tale can be illustrated with a simple example among the countless involving corporate bonds, bank loans, and all manner of securities. Barely three years after the Asian Financial crisis of 1997, there was almost a trillion dollars in credit default swaps outstanding. But lo and behold, by the time the subprime mortgages debacle erupted that number had grown to a mindboggling \$2 trillion.

Welcome then to the new millennium version of the South Sea Bubble where "Every fool aspired to be a knave" and "the greatest ladies thither came...and pawned their jewels for a sum to venture in the Alley." In our time, who are these fools and who would be the ladies?

Indeed, T.S. Eliot's *Burnt Norton* comes to mind:

Time present and time past

Are both perhaps present in time future, And time future contained in time past.

This is not poetry for the sake of poetry but we find it difficult to shake off that surreal *deja vu* sense of inevitability. While the Asian crisis opened up key questions of market liberalization and as some would say, the abysmal failure of the Breton Woods institutions, this recent debacle appears to have gone the opposite way. In this new reality, the United States, the land of primordial free enterprise, is in fact forging the way ahead for even greater

regulation while the European nations have renewed their call for global financial policing. We see, for example, the creation of a new consumer protection agency in America with such sweeping powers that readily call to mind the Orwellian big brother more ominous than even Homeland security. There is even talk of a global economic council comprising the Group of 20 and Group of Eight leading nations as a new body to oversee the proper functioning of the global economy.

This inevitably brings up the larger issue of the role of the state in the economy, one which is not merely germane to the subject of reform after crisis but which strikes at the very root of government. Indeed, it goes back to the controversial discourse that has pitted Keynesians against Hayekians for more than half a century.

This begs the question: What is the appropriate role of government in the economy? Or is this question moot given that in this battle at least for now, absolute free marketers seem to be fighting a war of futility as we see extensive reform programs being executed across the globe? We see that the initiatives are being driven by the overriding need to focus on the role that regulators can play both in steering the course ahead and in order to avoid the pitfalls of the future.

The argument is that in balancing the propensity for greed, anything in the market that is prone to collapse or systemic disruption ought to be regulated, not only in the aftermath of a crisis but at all times to prevent crises from taking place in the first place, or at least to mitigate their impact. Given the increasing sophistication of global financial markets, this principle cannot be applied only to banks. Sovereign wealth funds, private equity, insurance and mortgage cannot be exempt from the rules which have been devised to govern traditional financial transactions and instruments.

There are a few key principles to keep in mind when we look at reform so that 10 years from now Asia does not find itself revisiting the unlearned lessons of 1997. The first is the practice of prudence and the concern for accountability. This is of course a clear indictment, as alluded earlier, against the gross misuse of credit instruments, debt and speculative actions that led to the 2008 meltdown.

Asian economies have made in most cases the right decision to pump prime economies which were broadsided by the global recession but increased spending in stimulus packages may precipitate a new wave of privatizations. In principle we have no grouse with the promotion of free enterprise. Government has no business to be in business but without the prerequisites that must be fulfilled for such a colossal enterprise, privatization would merely be a euphemism for privatisation.

Also it is important that the human element of this endeavour not be overlooked. Despite what some economists may say about the functioning of markets, social justice must remain one of the main purposes of governments. Despite all the proselytizing of laissez faire economists that an invisible hand will create acceptable equilibriums, we rarely find examples in the short or medium term that prove the point. On the contrary we know that the free market system has generated externalities that have led to gross inequalities of income distribution, which means rampant poverty and marginalisation. Governments therefore should undertake integrated plans for poverty reduction in the long run while ensuring a comprehensive support system for the poor and economically marginalized.

Government should also not lose sight of this in their efforts to jumpstart Asian economies. Merely getting growth targets back in the black is hardly an indication that the recession has been overcome. Perhaps the most serious lingering effect of this crisis will be

persistent unemployment and under-employment, particularly in the informal sector in the poorer nations.

Globally, it is estimated that because of the growth slowdown, 89 million more people will be living in extreme poverty on less than \$1.25 a day by the end of 2010. The corresponding figure on a \$2 a day basis is as high as 120 million. In the East Asia region, about 10 million more people will be unable to escape poverty as a result of the crisis.

And there is evidence to show that irreversible damage is inflicted on school enrollment, particularly among girls, nutrition healthcare in the aftermath of deep recessions and bouts with unemployment in developing countries. By ignoring these problems in the pursuit of economic growth governments would most likely trade one problem for a host of others including rising social discontent.

In cases where the government is incapable of handling the problems and devising sustainable policy solutions; when it is itself the cause of the failed policies, one cannot overemphasize the concurrent need for strong institutions of civil society including free and fair elections, a vibrant and independent media and a judiciary that is and is seen to be beyond reproach. Only then can we expect a correction in the system by virtue of the power of the vote.

This is where we cannot overemphasize the importance of liberal constitutionalism as a long-term strategy even as the argument is advanced that authoritarian regimes practicing less than normal free market policies fared much better. Constitutionalism, if properly conceived, may provide the institutional reliability and accountability upon which sustained development depends. Almost as a knee jerk reaction, we saw a flood of sweeping regulatory reform of the financial sector which now appears to have petered out reflecting the vagaries of human nature and political reality.

But just as we had thought that the financial crisis of a year ago was fading into a distant memory, Dubai has given us a new kick in the head.

The lessons that can be drawn from the recent experience of East Asian economies appear to reinforce the argument that places the importance of market strengthening and government systems in the sustainability of economic recovery for which there are no short cuts.

While I have been critical of the Bretton Woods institutions, particularly the IMF, which has been the target of criticism for its lack of legitimacy, it appears that there is now a renewed sense of reliability in combating the global crisis with foundational and substantive reforms going beyond the financial sector. The need for better regulation as we alluded to earlier, a better way of handling sovereign defaults and managing risks and even the idea of the creation of a new global reserve system.

China and India, by virtue of their size, can go far to replace demand domestically by simply dialing up government spending. But smaller economies which relied on the export model will have greater difficulty recovering from the recession. Serious structural changes are necessary throughout the region to forge an economic community.

There is an increasing fear that the lax monetary policies by central banks worldwide are creating asset bubbles that would set the stage for another crisis. Hong Kong is high on the potential "boom and bust" list. Dubai, overwhelmed in speculation run amuck, has now to pay the price of its profligate ways. The debt debacle opens up more than just cash flow problems arising from over-the-top development. More significantly, universal issues which plagued the subprime crisis are clearly at the forefront and these would include questions of transparency, accountability and governance.

There is much merit in Polonius' advice that borrowing dulls the edge of husbandry, Japan and Korea being the prime examples of high savings rates and greater prosperity. China with its huge reserves and savings will be the world's largest economy by 2020.

Undertakings that would incur billions of dollars of tax payers' money must be subject to strict rules of governance, transparency and accountability. Market friendly policies and "pro-growth initiatives" surely cannot be allowed to be exploited by a few at the expense of the more deserving majority. Flexibility and common sense must prevail in managing the economy by taking the middle path in as much as there must not be too much of anything, even of the virtues just as too much courage is rashness, too much generosity is extravagance and too much accuracy is hairsplitting.² In Islam we call it the *awsatuha* just as we are familiar with the *chung yung* of Confucius. Translated into practical terms, it means that when the economy is underperforming below its potential, increased public expenditures would be needed. Obviously, fiscal discipline must be maintained to ensure that the consequent fiscal imbalance remains within manageable levels at all times.

Without getting into specifics, we would welcome efforts to redress the fundamental inadequacies of the global financial architecture but such endeavors must be coordinated across countries, without which no meaningful reform of financial markets can be realized. This warrants an entire relook of the Breton Woods system. Ad hoc solutions to specific problems must give way to a holistic and systematic approach to tackle all issues.

Conclusion

It has often been argued that the emphasis on political freedom, liberties and democracy is a specifically western priority. Economic development, it is said, must precede freedom. Empty stomachs do not shout for liberty, but for food. But why should development become a trade-off for unfreedom? Why should fundamental liberties be eroded and dissent muzzled in the name of development? If development is to enlarge freedom, then substantial development enlarges freedom substantially, for "it is hard to think that any process of substantial development can do without very extensive use of markets".

Much good has come out of this and great strides have been made in various areas which will help to fortify the economies in the region when crisis strikes again. Various reputable studies show that in the area of trade, for example, intra-regional exports have almost tripled, China being at the centre and the rest are riding piggy back. Considerably much more has been expended on research and development while higher education has made leaps and bounds. The same is said about resource allocation, reduction of systemic risk and the gaining of financial depth.

References

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