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Keynote Address

at the Launch of UNDP's Regional Synthesis Report on the Global Financial Crisis and the Asia-Pacific Region and the Malaysian Economy: Impact and Responses

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Nikko Hotel, Kuala Lumpur

Yang Berbahagia Tan Sri Mohammed Jawhar Hassan,

Excellencies,

Ladies and Gentlemen,

It is a great pleasure to be here today speaking to such a distinguished and eminent audience at a pivotal time in global and financial developments. It is now more than a year since the crisis erupted. But as we are seeing with the news coming from Dubai the ripple effects of the crisis are still unfolding and more may be coming.

First, we must recognise that the crisis did not originate with the collapse at Lehman Brothers. That was the day Wall Street and other financial centres felt the crisis. But in many ways the crisis had already begun for millions of people and policy makers in many countries well before that day. The massive increases in fuel prices in 2008 followed by the huge increase in food prices – linked to the increase in fuel prices---- were all part of the same excess that culminated in the collapse at Lehman and what we now call the global financial crisis. Some have called it a triple crisis – but to my mind it's all part of one and the same crisis caused by huge increases in demand generated by very easy monetary policy. The crisis for many poor and vulnerable populations and for many governments had started well before 2008 as they dealt with the huge volatility in commodity prices. As we see signs of recovery from the downturn of the financial crisis we also see that food and fuel prices have started to rise again. These are signs that unless we rethink the entire global development model we may well be back to square one again.

Second a question often asked is whether Asia is de-coupled, or re –coupled with the Western economies? More than a year after the global financial crisis, it appears that both perceptions are at least partially correct. The global crisis has indeed affected developing Asia adversely, but unlike many other regions of the world, on the whole, in developing Asia the crisis did not cause an overall decline in GDP but a deceleration of growth, and the subsequent "recovery" is also currently seen to be faster and more pronounced than elsewhere. Asia is cyclically tied to the developed world but its long term growth rates are nevertheless much higher and can become de-linked from the growth of the developed world with appropriate policies. If this happens what many have predicted---- that the 21st century will be the Asian Century--- may indeed be closer at hand. But there are worrisome signs that many in Asia may be tempted to try to return to the old export led growth model, which is unsustainable given the debt-laden economies of the West. If Asia wants this to be its century it must more vigorously find an alternate development path.

In some ways the genesis of today's dilemmas goes back to a decade earlier, when some countries in Asia suffered what is now known as the Asian financial crisis of 1997-98. At that time you may recall that many Asian developing countries adopted the export-led growth model, with their currencies tied to the US dollar. With low wages and a vast pool of surplus farm labour which migrated to the new factories established with large inflows of FDI, Asia's most dynamic economies remained internationally competitive, their domestic consumption remained low and they were able to capture a growing share of world markets. After that crisis, savings rates remained high but investment rates tended to fall because of the combination of reductions in public and private investment rates.

As a result, globally, the previous boom was associated with developing Asia subsidising the West: through exports of cheaper goods and services, through net capital flows from developing countries to the US in particular. In this boom, domestic demand tended to be profit-led, based on high and growing profit shares in the economy and significant increases in the income and consumption of newly globalised middle classes, which led to bullish investment in certain non-tradable sectors like financial assets and real estate as well as in luxury goods and services. Growing trade linkages within Asia emerged because of the creation of investment-driven export platforms catering to developed country markets, with a high degree of interdependence of production processes. This helped smaller Asian countries benefit by supplying raw materials and intermediate products to leading Asian economies, as well as service hubs like Singapore who supply key financial and transport linkages.

However, in most countries, because wages stayed low and agriculture was often neglected, rapid economic growth was associated with high and growing inequality. Insufficient policy attention to rural areas and agriculture meant that an agrarian crisis emerged in many countries. Meanwhile, competitive pressures and conditions of excess labour supply meant that wage shares of national income tended to remain low or decline, while employment tended to become more fragile and insecure despite the boom. Weak social protection and inadequate public spending on basic services meant that any shocks (whether in the form of natural disasters or economic crisis) were likely to cause more people to fall into poverty. This is not to deny the very significant drop in poverty that occurred in some countries (most notably China, but also Vietnam, Thailand, Malaysia and to a lesser extent in other Asian countries), but simply to note that the growth would have had an even bigger impact on poverty reduction if it had not been associated with rapidly increasing inequality.

In this context, the current global crisis has directly hit the Asian region through its negative effects on exports to developed markets, which declined sharply and created ripple effects in reductions in intra-Asian trade. However, it is also true that the substantial clean-up of the banking sector and corporate balance sheets that had occurred in the wake of the Asian crisis, as well as a more cautious and calibrated approach to banking and financial sector reform in several countries with Malaysia and the leadership of Malaysia's Bank Negara, its Central Bank, being a leading example of this, prevented extremely adverse financial effects and has allowed the region as a whole to recover faster from this crisis. Remittances into Asia have also remained remarkably resilient so far (recent developments in Dubai are worrisome for remittances, however). Employment declined sharply in export-oriented sectors, creating negative multiplier effects across other sectors. Quick impact surveys done by UNDP in collaboration with others and reported in the study we are presenting today show that the effects on social sectors and on human development conditions in general have been significant.

The emergence of new production networks and linkages in developing Asia, particularly because of the recent rapid expansion of China and India, assumes particular significance given the volatility of trade and investment flows from the developed world. Greater trade integration within developing Asia is becoming an important avenue for future economic expansion of the region. But while more focus on intra-Asian linkages may serve to redirect both trade and investment within the region in positive ways, overall developing Asia cannot seek to re-export its way to growth to the same extent it did after the 1997-8 crisis in the near future. This in turn requires a shift towards domestic demand led growth particularly in the countries with economies large enough to sustain this shift. Such a shift can occur through public expenditure to provide more basic goods and services, more resources directed to rural areas as well as better social protection, in addition to directly redistributive strategies. Whether this is possible in a sustained way presents a big question mark on the strength of the recovery that has just started, which still remains heavily dependent on the huge fiscal and monetary stimuli. There are worrisome signs that many Asian countries, including Malaysia, will forget that the old growth model with all its imbalances is unsustainable. While the US external deficit has declined, it still remains too high. Most Asian currencies, including the Malaysian Ringgit, have appreciated relative to the US dollar in the last few months. But the Chinese Yuan remains linked to the US dollar creating huge shifts in its value relative to other Asian currencies and increasing the pressure for competitive devaluations to try and maintain export shares in a shrinking global market.

The global financial crisis has brought about international recognition of the dangers posed by volatile finance and the need to regulate finance in specific forms, including in commodities markets, in derivatives and in various new financial instruments and innovations that hide risk. While there have been some moves to regulate finance in the developed financial centres of the world, such moves are still halting, patchy and inadequate. Meanwhile, however, there is a particular need for developing countries to develop capital account management techniques that take into account the new international reality and to design domestic strategies for financial deepening and inclusion that are not prone to the same tendencies of volatility and fragility. In particular, the impact of financial speculation is causing very rapid and extreme movements in the prices of certain essential commodities such as food and fuel, because developing countries are forced to deal with the effects of these movements on real economic variables and living conditions. Asset bubbles are again forming which could be destabilising when the US monetary policy is reversed.

The previous discussion suggests that the current recovery may be temporary and must be treated as an opportunity to re-direct growth in Asia towards more equitable and sustainable trajectories. Six broad areas of public intervention create an agenda for a new Asian century in which the legitimate aspirations of the majority of Asian citizens can be met:

1. Rebalance Asian growth, from a focus on export-led to more regional and domestic demand expansion. A key driver of this has to be a much bigger shift to domestic demand in Asia, including Malaysia. Both household and corporate savings remain quite high leading to net savings. The counterpart of these savings has been large reserve accumulation but as President Obama recently stated at the APEC meeting –Asia should not rely on the return to the old ways of spending by the debt laden consumers in the USA.

2. Make the economic growth process more inclusive and employment intensive: direct resources need to be invested in sectors in which the poor work (such as agriculture and informal activities), in areas in which they live (relatively backward regions), in factors of production which they possess (unskilled labour) and in outputs which they consume (such as food). Vietnam provides a very good example of a country that achieved almost 8 % growth for a decade or so prior to the crisis with very little increase in inequality and with rural incomes rising as rapidly as urban incomes. China in the 1980's, India in the period from mid 1980-1990's and Indonesia in the

period of the 1980's all achieved respectable growth with equitable development.

3. Re-orient growth in Asia in cleaner and greener directions: shift from carbon-based (coal and oil) growth to solar, nuclear and renewable energy; emphasise cleaner transport systems and better urban planning and management, protecting and nurturing the regions' dwindling water and other natural resources, and mitigating the effects and adapting to the possibilities of climate change-induced natural disasters. The new announcements by China to reduce its carbon intensity by 40-45% by 2020, followed by India's announcement to around a 20% cut in its carbon intensity are excellent offerings just before the Copenhagen Summit as they will bring life back into the possibility of a climate deal.

4. Provide much better social protection, with more funding, wider coverage and consolidation, more health spending and robust and extensive social insurance programmes including pension and unemployment insurance. As the report presented to you later shows, Asian social security systems remain very weak with less than 20% of Asia's population have any access to health insurance, old age pension or to unemployment insurance. New schemes

have been announced such as China's rural health insurance and India's rural employment guarantee scheme as well as rural health insurance. Thailand's 30 baht scheme is quite commendable but out of pocket health expenditures in China and Vietnam remain very high – amongst the highest in the world. In this regards Singapore's workfare schemes deserve a closer look as they are not the typical developed world welfare schemes but may fit Asian reality much better.

5. Improve financial sector performance while ensuring financial stability, by emphasising financial inclusion and deepening and strengthen capital account management. This is especially important now because with very easy monetary policy there are signs that asset bubbles are forming and Asia remains very vulnerable because with its faster recovery it is attracting a large influx of short-term volatile capital. Property markets are also extremely frothy all across Asia but with capital flows which could easily reverse.

6. Expand Asian trade integration and monetary and financial co-ordination. For relatively trade dependent and moderately-sized economies such as Malaysia, greater integration with the ASEAN market would be of immense benefit in terms of expanding their domestic demand base. In the case of

Malaysia, a larger single market within ASEAN would also provide a stronger economic base to manage and ride out systemic external shocks. ASEAN in many ways provides the base for an Asian common market as it builds free trade arrangements with ASEAN plus 3 and with India. Malaysia, given its unique ethic mix which includes a substantial Malaysian Chinese and Malaysian Indian population, is particularly well placed to focus on the Chinese and Indian markets which will be crucial in the 21st "Asian" century. The Chiang Mai Initiative of $ 120 billion announced recently is promising but could be further expanded.

Asian leaders recognise these directions but their actions remain piecemeal, fragmented and still not well coordinated. Six major Asian countries are now represented at the G-20 instead of one at the G-7, a clear recognition of Asia's rising share of the global economy. To maintain this shift, a fundamental rethinking is needed in Asia's development strategy. Without it we run the danger of a cycle of more crises as imbalances persist.

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