

ADB and the Asian Crisis

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Following the successive breakdown of five Asian currencies in 1997, what has started as a miracle for Asia turned out to have a tragic ending. For Asia Five (Indonesia, Korea, Malaysia, the Philippines and Thailand), the crisis has severely uprooted all the foundations that have been laid in search of benefits of industrialization.

ADB's RESPONSE TO THE CRISIS

The Asian financial crisis was essentially mitigated by committing the error of moral hazard and asymmetric information (between banks and firms), all boiling down to the bailout guarantee provided for by the governments in the region. As such, the Bank redirected its efforts in penalizing those whom it pinpointed as the real culprits of the crisis -- negligent governments, banks and firm officials. Although bad governance is mainly to be blamed, the Bank realizes that squeezing credit out of firms would rob them out of their ability to be competitive; penalizing banks, however, would only intensify the diminishing trust of the public on the banking system. Thus, the need to restore the banking sector will have to be made the soonest as not to dry out firms and lose public trust.

The optimal solution for the ADB seemingly is allowing a more active and interventionist role for the state in order to stabilize the banking sector¹. The plan is to make governments finance the recapitalization of the banks through increased government borrowing in the domestic and foreign markets. In effect, the positive fiscal balance that used to be exhibited will now be made to reach its negative levels with government expenditures exceeding revenues. Privatizing state assets, including banks that have been restored back to health, will pay the debt that will be incurred.

Contrary to what ADB and other multilateral lending institutions have been hammering to governments before, reverting to state-intervention as the most radical solution once more heightens the role of the government in economic recovery. The Bank admits that market failure, from which the crisis has resulted, can only be corrected by government intervention.

Noticeably, government spending has indeed increased even at the start of 1998. However, much of the funds that are being utilized to finance such spending were and are still being sourced from the international market.

SPECIFIC ADB INTERVENTIONS

SUPPORTING IMF-LED BAILOUTS

The Bank has helped implement IMF's economic strategy in response to the crisis, i.e., through banking, capital market and international competitiveness assistance, including:

- stabilizing the countries in the macroeconomic level by a) supporting high interest rates in order to defend the exchange rates from further losing their values and reverse the outflow of capital; b) implementation of tighter fiscal policy to support the current account adjustment and provide the funds that would be necessary to bail out sick banking systems; and
- supporting structural changes in the region particularly in the reforms of the region's banking systems, the breakup of monopolies, the removal of barriers to trade and substantial improvements in corporate transparency.

In 1997, the IMF approved \$35 billion worth of loans to Indonesia, Korea and Thailand. The ADB, World Bank and other bilateral sources committed an aggregate of \$77 billion.

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¹ Kumar, R. & Debroy, B. The Asian Crisis: An Alternate View. July 1999. ADB.

In the same year, a big chunk of ADB's lending activity was dedicated to the crisis-hit countries. Among the Bank's major loan operations are the following:

- A total of \$1.7 billion or more than one fourth of the Bank's total lending was rolled out to the financial sector. Of this amount, \$1.5 billion was lent to Indonesia for its Financial Governance Reform. Thailand and Korea followed next.
- Social sector programs were also supported by the Bank in order to minimize the soften the effect of the crisis to the hardest-hit countries' poorest groups. A part of the loan, worth \$800 million, supported Thailand and Indonesia's social sector programs for the continuous access of the poorest groups to basic services (essential nutrition, health and education).
- A \$1.5 billion loan was provided for to Indonesia to support a major streamlining of the regulatory framework and provide transparency in the banking subsector.
- The Bank has also chipped in \$4 billion in the IMF-led multilateral assistance package to Korea for the restructuring of financial institutions, strengthening of regulation and supervision and to undertake measures that will liberalize and further develop the country's capital market.
- A \$300 million loan was made available to Thailand in order to enforce reforms in its financial sector.
- \$50 million (of the \$1 billion-loan from ten leading international banks) assistance to Thailand's export-financing facility. Technical assistance grants accounted \$2.6 million for banking, capital market and international competitiveness reforms. This amount was funded by the Bank-administered Japan Special Fund.

In totality, ADB has pledged almost \$8.7 billion for the support packages of Thailand, Indonesia and Korea alone.

ASIAN MONETARY FUND

In 1997, Japan attempted to institute a \$100 billion Asian Monetary Fund with the primary purpose of providing an alternative source of funds for the crisis-hit countries. This regional fund was supposedly for the benefit of the Asian region so that countries

do not have to succumb to only one lender of last resort: the IMF. This came about as a mutual consensus from borrowing countries that had been misguided by IMF policies and conditionalities. Unfortunately, the US and the IMF readily gunned this down.

In the ADB's annual meeting last year, 13 Finance Ministers in Asia arrived at a consensus on the creation of a network of currency swaps among their central banks in order to defend local currencies under attack without running to the IMF for assistance. Should a country or some countries experience liquidity problems (as what happened during the crisis) they would be able to draw US dollars from one another's foreign exchange reserves. US objections didn't warrant any development of the idea.

JAPAN-FUNDED ASIAN CURRENCY CRISIS SUPPORT FACILITY (ACCSF)

Various mechanisms were set up by the ADB to serve as a conduit for funds to the crisis-hit countries. Specifically, it has in its responsibility the administration of the Japan-funded Asian Currency Crisis Support Facility (ACCSF). This special fund was set up in 1999 specifically targeted to help the developing member countries affected by the crisis. The ACCSF serves as the venue for assisting countries with interest payments, technical assistance grants and guarantees. To date, the fund has already disbursed \$10.5 million, of which, 51.4% account for social infrastructure while only 28.6% are for financial restructuring.

ASIA RECOVERY INFORMATION CENTER WEB SITE

In 1999, the Bank approved a \$1-million technical assistance grant for the establishment of the Asia Recovery Information Center (ARIC). The utilization of an internet-based facility (www.aric.adb.org) provides room for the analysis and exchange of information regarding the social and economic impacts of the financial crisis. Currently, the ARIC provides information as to the pace and sustainability of the economic recovery process in the Asian region. Of the data disseminated are:

1. key social, economic and financial indicators;
2. development assistance initiatives and domestic

- programs including policy, legal and regulatory reforms;
3. emerging assistance needs identified by the affected countries or aid agencies; and
 4. public, private and non-governmental sources of expertise.

lending beyond limits, excess leverages by corporations, abuses from majority shareholders and political interference in business decision making.

ADB ON ASIA'S RECOVERY

After endowing the five hardest-hit Asian countries with billions-dollar loan packages, the ADB is posed to defend the effects of such loans. Foremost of the issues is continued downward movements of currencies that continue to alarm the public. From January to September 2000 alone, Indonesia, the Philippines and Thailand's currencies have plunged by between 20% and 11% (although Malaysia's currency held on with that of Korea slightly appreciated).

In its Asia Recovery Report 2000 (ARR), the ADB thinks that despite the retreats in the region's equity markets and falling currencies, Asia is unlikely to dive into another financial crisis. It has been noted that the current size of net capital outflows is not as large as it was in 1997 and 1998. From 1999 onwards, the main problems that economies are facing are debt repayment, capital withdrawal from stock markets and a slowdown of foreign direct investments. These problems are not the same as the short-term debt mismatch that occurred prior to the crisis. Hence, there is no reason for the public to be alarmed.

ARR 2000 also observed Korea and Malaysia as two of the countries that are making a headway recovery in terms of bank and corporate restructuring. For both countries, the proportions of their nonperforming loans have already declined by late 1999. Thailand, which opted a market-led strategy, registered a decline in its non-performing loans and continues to do so. The Philippines, on the other hand, is shown to have some signs of distress in its banking sector as a result of an increase in its nonperforming loans. Indonesia continues to struggle as it continues to face a big number of insolvent banks.

Despite these acclaims on economic performance, the loans have yet to see results on changes in the factors that have brought about to the crisis. Prudential standards continue to be loose, continuous