ADB

Technical Assistance Consultant's Report

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REG: South Asia Forum on the Impact of Global Economic and Financial Crisis

Prepared by

Centennial Group Holdings, LLC

2600 Virginia Ave NW Suite 201 Washington DC USA

For Asian Development Bank

Asian Development Bank

CONTENTS

EXECUTIVE SUMMARY

The ADB South Asia Forum on the Impact of Global Economic and Financial Crisis, held in Manila on March 9 -10, 2009, was the first of a series of four to be convened by the ADB in response to the global financial and economic crisis.

This first forum was to provide a platform for South Asian countries to review how each of them were being affected by the global crisis and the measures that were being taken to preserve financial stability, stimulate growth and ensure social protection in the face of a world economic recession. The next steps would be for the group of senior officials from national governments and regulatory agencies to deliberate with experts from the Asian Development Bank, regional agencies and international research organizations on additional policies to cope with the current crisis and how they should go about taking long term policy measures to build up the resilience and strength of their economies.

Framework for Assessing the Impact of Global Crisis on South Asia

President Haruhiko Kuroda of the ADB summarized the impact of the crisis on developing countries in Asia as cutting across four dimensions, namely:

1) The impact of the economic slowdown on the exports of Asian countries across the entire value chain and its consequences on employment and GDP growth.
2) The impact on the financial system as a result of outflow of foreign direct investment from Asia's financial and capital markets, which in turn is depressing domestic equity markets and contributing to the tightening of lending policies.
3) The impact on liquidity in domestic financial markets. The constraints on credit availability will be even more constrained for the lower end of the market, namely credit for labor-intensive small and medium enterprises and micro-enterprises.
4) The potential impact, though not fully evident yet, on informal social safety nets by virtue of reduced remittances received from overseas migrant workers, whose employment are being affected by the economic slowdown and capital expenditure cutbacks in the host countries.

For South Asian countries, the effects of the crisis were transmitted specifically through the channels of trade, financial flows, remittances, commodity prices and foreign direct investments.

- **Trade**: the volume of exports of goods and services was contracting in most open economies as global demand declined.
- **Financial flows**: Flows of portfolio capital to emerging markets had fallen sharply because of increased risk aversion in developed countries.
- **Remittances**: Remittances were coming under pressure as major labor-importing economies, including the Middle East, were beginning to retrench foreign workers, following the slowdown in domestic investments.
- **Commodity prices**: With the spread of global recession, commodity prices had fallen sharply, reducing incomes to households in emerging countries which exported such commodities
- **Foreign direct investment**: As global companies' perception of the risks and rewards of investing income became more cautious and as raising funds for investment became more difficult, foreign direct investment in emerging markets also declined.

A prolonged economic slowdown in G3 countries will also unleash a different set of problems and risks for emerging markets:

- Economies with high levels of maturing external debt will face difficulties of re-financing this debt and at higher costs.
- There are the dangers of protectionism gaining ground, although this may be in disguised forms of trade distortions.
- The risks of global deflation could well rise if credit mechanisms remain impaired, GDP growth of the major economies remains below potential for a prolonged period and asset prices fall across the board for many asset classes.

The policy response in South Asia thus becomes crucial. In the short term, policy should be directed at mitigating the impact and possible risks of the global crisis through a combination of monetary, fiscal and other measures. In the longer term, policy actions should promote faster economic growth and improved resilience to future global economic shocks, such as increased diversification of the economic base, stepped up infrastructure development and increased regional cooperation and coordination.

South Asian Country Experiences varied according to openness of the economies

The seven South Asian countries (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) experienced different levels of exposure to the global crisis. India, Pakistan and Sri Lanka were beginning to feel the impact of the crisis with the slowdown in exports, foreign direct investment and remittances. The Maldives, which is largely dependent on tourism, was facing the repercussions of a decline in tourist arrivals from Europe. Bangladesh had shown resilience so far but faced the risks of impending slowdown of exports to the United States and Europe as well as lower remittances from migrant workers in the Middle East and parts of South-East Asia. In comparison, Nepal and Bhutan were the two smaller economies in the region which have been relatively insulated from the global crisis by virtue of their dependence on India as their major trading partner and their less developed financial systems.

On the whole, the South Asian governments have been proactive in taking monetary and fiscal measures to contain the adverse effects of the crisis, which at the onset was the problem of high inflation as a result of the surge in energy and commodity prices in the first half of 2008. With the abatement of inflation following the decline in energy and commodity prices towards year-end, the focus of governments turned to initiating short-term measures that would mitigate the threats of a worldwide recession. However, long-term strategies to accelerate economic growth and enhance the resilience of each country's economy to future external shocks were not apparent as yet.

Among the short-term measures to mitigate risks of recession were those relating to the following areas:

a) **Monetary policy easing** was adopted in India, Sri Lanka and Bangladesh where there was room for interest rate reductions to expand credit availability.
b) **Fiscal stimulus packages** were introduced in a few South Asian economies like India and Sri Lanka despite limited fiscal space. The Government of India, notwithstanding a large pre-crisis fiscal deficit that was weighed down by earlier policy commitments to pay increases for civil servants, energy subsidies and farm loan waiver programs, accommodated additional tax incentives for infrastructure development and export promotion. In Sri Lanka, stimulus measures included the lowering of fuel prices, export incentives and exemptions for the tea industry.
c) Other measures focused on the major channels of impact of the global crisis:
    - **On trade**, the Government of Pakistan was engaging in dialogue with domestic and international bodies to maintain market access and intra-regional trade linkages; in Bangladesh, a high-level committee of the Finance Ministry was looking into the issue of cash incentives for exporters of apparel.
    - **On remittances**, existing social safety nets were being strengthened as in Pakistan; agreements on manpower exports from Bangladesh to countries like Libya, Jordan and Bahrain were being negotiated; the Government of Sri Lanka was offering higher interest rates on overseas worker accounts to encourage higher remittances.
    - **On international aid**, countries (like Sri Lanka, Nepal and the Maldives) needed emergency external funds to augment declining export proceeds, shrinking reserves and capital inflows.

Additional Short and Long-term Measures Recommended

During the discussions and exchange of views during the Forum, there was general agreement that in view of the severity of the current global crisis, more needs to be done to build up the resilience of the South Asian economies to a cyclical downturn and to strengthen them structurally for sustained longer term economic growth.

Some of the additional short and long-term measures recommended for specific countries were the following:

India:

Moving forward, the additional short term measures need to focus on:

- Further infusion of liquidity and rate cuts;
- Regulatory changes – such as simplification of ECB requirements and FDI guidelines;
- Creating more fiscal space for states; and
- Improve implementation of the announced fiscal stimulus measures. As the crisis is no longer a generalized one, the relief extended under the stimulus packages must be sector specific and location specific.

Over the long-term, the Government would have to focus on:

- Restoring fiscal discipline and fiscal consolidation – rationalize subsidies, strengthen tax administration, enhance the efficiency of public spending;
- Regulatory changes to facilitate greater private sector investment, strengthen corporate governance, and continue with simplification of procedures and processes so that the overall transactions costs of doing business in India goes down;
- Infrastructure development – including through public-private partnerships;
- Raising productivity; and
- Regional cooperation to foster aggregate demand. Develop cross-border transport infrastructure to support a region-wide supply chain.

Pakistan:

On the way forward, additional effort should go towards:

- Infrastructure development, especially in the area of power and gas, where there is potential for greater public-private partnerships (PPP). Because of the lead time needed, PPP should be expedited.
- Promoting growth of a domestic consumption market by improving the distribution chain in the country.
- Augmenting external sources of multilateral financial assistance with regional cooperation initiatives, such as currency swap facilities with

central banks.
- Strengthening Pakistan's banking system through prudential guidelines and a review of capital adequacy ratios.

Bangladesh:

The immediate policy responses to the challenges of the global crisis included the following:
- Ensure effective monitoring of key commodity markets;
- Early implementation of development programs;
- Export incentives for the power generation industry;
- Ensure food security; and

The relatively low level of volatility in the Bangladesh economy offered the country an opportunity to consolidate efforts towards long-term measures of promoting sustainable and higher levels of growth and escalating itself to becoming a middle-income country. Among the suggestions for long-term measures were the following:
- Proactiveness in seeking labor deals in the Middle East on the one hand and on the other, improving the banking infrastructure to absorb the remittances by foreign workers;
- Programs to promote skills training as a measure to raise the earnings potential of workers before they are sent abroad;
- Diversify its export destinations;
- Use its experience in microfinance for the poor to improve the financing of small and medium enterprises (SMEs); and
- Strengthen the government institutional framework.

Nepal:

Although Nepal had weathered the global crisis quite well so far, it remained vulnerable to the impacts, on unemployment in particular, transmitted through the tourism and remittances channels.
- Nepal, whose fiscal deficit was at a prudent level of 2% of the GDP, has the fiscal space for stimulus packages as well as for long term measures of promoting sustainable infrastructure growth (especially hydro-power development and telecommunications), creating employment and removing bottlenecks to business investment.
- It is equally important for Nepal to continue with the broader objective of macroeconomic management while addressing structural issues of raising productivity in the manufacturing sector. Resolving power shortages in the country is key to the productivity issue.

Sri Lanka:

Faced with the multiple problems of inflation, acute shortage of foreign exchange and limitations in raising external funding, the IMF's Article IV Assessment reported that the real effective exchange rate of the Lankan rupee was overvalued and contributed to external instability. It had called for greater flexibility in exchange rate management. Reserves build-up should be complemented by an IMF program to regain confidence in the economy.

The long-term measures to strengthen the economy include the following:

- Diversifying its economic base and export basket.
- Improve the management of reserves.
- Fiscal consolidation
- Development and deepening of the capital market through education and reform measures – amendment of listing rules of the Colombo Stock Exchange, capacity building in supervision and development of markets.
- Regulatory changes to facilitate greater private sector investment and lower overall transactions costs of doing business.
- Infrastructure development.
- Regional cooperation to foster aggregate demand.
- Develop cross-border transport infrastructure to support a region-wide supply chain. Given the close ties between Sri Lanka and Bangladesh, there should be greater cooperation between the two countries to exchange good practice and to establish economic links.

Bhutan:

Bhutan is a land-locked country in the Himalayan Mountains with close links to India in terms of trade and a currency peg (the Ngultrum and the Rupee trade on par). The economy is driven by hydropower production, 90% of which is exported to India.

Bhutan's macroeconomic indicators remained strong with a low budget deficit and a surplus on the balance of payments current account. Since the economy was less affected by the global financial and economic crisis, not much policy response had been necessary. However, urgently needed is an ADB assistance program to develop Bhutan's statistical systems for monitoring the economic situation.

As a long-term measure, Bhutan needs to diversify its economic base away from its heavy dependence on hydropower.

- Although Bhutan is financially not globalized, it is an aid- and import-dependent economy. The build-up of official reserves (amounting to 10 months of imports) is primarily from international aid, which therefore has to be prudently managed.
- The banking sector is highly regulated, there being only two commercial banks in Bhutan, but two new foreign bank licenses have recently been issued. Credit exposure to the construction and

manufacturing sector and the resultant mismatch arising from borrowing short and lending long should be addressed.

- Bhutan's capital market is not developed and will need technical assistance from the ADB to develop its stock exchange while capacity building support could come from Nepal, Bangladesh and India.
- Fiscal discipline is not too satisfactory and there is need for better coordination between fiscal and monetary policies.

Maldives:

The Maldives is a small island economy which is highly dependent on external demand for its trade and tourism services. As such, it is more vulnerable to the external shocks generated by the global financial crisis.

The Maldives economy was strong until its devastation by the tsunami of 2004. Since then, the current account deficit grew bigger, due to the higher import bill and excessive public spending on civil service wages, and has resulted in a shortage of US dollars in the local market. The decline in foreign exchange reserves was exerting pressure on Maldives' fixed currency peg with the US dollar.

Maldives needs urgent short-term and medium-term remedial measures to correct long neglected structural issues, which amongst others are manifesting themselves through the progressively rising fiscal deficit (2008:13.6% of GDP) and current account deficit (2008: 51.9% of GDP):

- The limited fiscal space has restricted the Government's ability to take policy measures to mitigate the impact of the global financial and economic crisis. Removing subsidies and rationalizing expenditures are essential to arrest the deteriorating fiscal and balance of payments situation.
- There should be a strategic plan to attract tourists to the Maldives, including diversifying its markets out of Europe to tap the Indian and Chinese markets as well as the middle-income tourists.
- The policy of the newly-formed government to privatize state-owned enterprises over three years may not be realistic. A 5-year time frame would facilitate privatization in three steps – first is to enter into joint ventures between public and private sectors; second to offer to institutional investors and third, to offer to investment by the general public.

Conclusions and Next Steps

1. The Forum had met its objective of sharing cross-country experiences on the impacts of the crisis and on the ongoing and planned measures to offset the adverse effects of the crisis on their respective markets and economies.

2. However, it was clear that greater regional cooperation and integration is needed to convert this crisis into an opportunity to strengthen policies and institutional framework to be better prepared for a recurrence of such a crisis in the future.

3. Whilst policy responses have to a large extent been country-specific, there are some common cross-country objectives to work towards collectively as a regional grouping. These common objectives include:
   - Preserving the hard-won gains against poverty;
   - Strengthening social safety net programs by sharpening their focus;
   - Resisting temptation to limit international trade and commerce;
   - Strengthening the financial sector regulatory framework, revisiting prudential guidelines and strengthening the capital adequacy of financial institutions;
   - Deepening and strengthening corporate governance, including compliance with stock market listing requirements, accounting and auditing procedures and enhancing transparency;
   - Investing in infrastructure for sustaining growth; and
   - Strengthening regional cooperation initiatives.

4. Ultimately, a global crisis requires a global solution. A longer-term plan for reforming the regulatory and institutional framework for the world's financial systems is needed. Asia must now take greater responsibility as a cooperative and responsible partner to ensure that the new financial architecture meets the challenges of a globalized world. To quote Mr. Michel Camdessus in his Keynote Address, the essential conditions to be fulfilled are:
   - Developing and emerging countries from Asia must take ownership of this new financial architecture and play their full role at all levels of governance, which includes:
     - Uncompromising surveillance;
     - Excellence in conduct of mutual policies and regional cooperation;
     - Active contribution to global coordination; and
     - Generous solidarity.
   - Active and forceful use of its voting powers in the World Bank and IMF and the proposed Global Governance Group.
   - Pursuit of regional cooperation in various forms.
   - Active participation in the Financial Stability Forum and the BIS.
   - Continued improvements in national regulatory and supervision systems.
   - Active role in correcting global macroeconomic and structural imbalances.
   - Generous contribution to rebalancing the financing of the global system, in particular the poorest countries.

5. In this context, the views of South Asian countries are needed on the appropriateness of some proposals where ADB could lend its experience and support. Among the key proposals are the following:

   a) **Maintaining Regional Domestic and Financial Stability.**
      Would South Asian countries want to consider a facility similar to the Chiang Mai Initiative (CMI) of ASEAN+3, which offers emergency liquidity injections to countries experiencing urgent liquidity shortage?

   b) **Building sound monitoring systems.**
      The crisis has exposed the weakness in the monitoring mechanisms of even the most developed economies. ADB will provide support in building the capacity of these countries to strengtheng the monitoring of the financial system and key economic sectors and to develop the supporting data base and statistical tools.. Recognizing the need for support may vary across countries, it is possible, that countries with advanced systems could assist the others. A strengthened monitoring system would provide the foundations for regional economic cooperation.

   c) **Connectivity.**
      Improving connectivity is essential for enabling countries of the region to access broader markets and consequently improve economic performance. Hence, there is potential for South Asia not only to integrate internally but also with other sub-regions, such as ASEAN and ASEAN+3 to evolve into a more vibrant Asian Economic Community.

6. To continue this dialogue, first forum recommended and ADB agreed to the expansion of the second forum. The participation from the outside South Asia region for the second form was originally planned in the mode of external regional association as observers), but ADB management agreed to extend the participation in the second Foum to include policy makers from individual East and Central Asian countries . ADB proposed to hold the next Forum in three or four months time with expanded participation of policy makers from East Asia, especially ASEAN+3, for cross sharing of experiences. The purpose of the Forum would be to:
   - Update on the unfolding impacts of the crisis and the needed responses as well as the results of the stimulus packages already undertaken;
   - Develop background materials for facilitating regional and sub-regional experiences especially on the proposals; and
   - In the context of proposals relating to a Chiang Mai-type arrangement and a monitoring system, assess where ADB support could be most effective.

"South Asia Forum on the Impact of Global Economic and Financial Crisis"

09-10 March 2009 – Auditorium B, ADB Headquarters, Manila, Philippines

AGENDA

RECEPTION SUNDAY, 08 MARCH

<u>06:30 – 08:30</u>	**<u>Cocktail and Pre- Registration at EDSA Shangri La</u>**

DAY 1 MONDAY, 09 MARCH

<u>08:15 – 08:30</u>	**Transfer from hotel to ADB headquarters**
<u>08:30 – 09:00</u>	**<u>Registration</u>**
<u>09:00 – 10:00</u>	**<u>Introduction</u>**
09:00 – 09:10	**Welcome Remarks** *Haruhiko Kuroda, President, Asian Development Bank (ADB)*
09:10 – 09:40	**Keynote Address:** *Michael Camdessus, Honorary Governor, Banque de France; Former Managing Director, International Monetary Fund (IMF)*
09:40 – 10:00	Discussion / Q&A
<u>10:00 – 11:30</u>	**<u>Session I – Global Economic and Financial Crisis and Impact on Emerging Markets</u>** *Chair: Makoto Utsumi, President and Chief Executive Officer, Japan Credit Rating Agency Ltd.; Former Vice Minister of Finance*
10:00 – 10:15	**Lessons from the 1997 Asian Financial Crisis** *Fidel V. Ramos, Chairman, Ramos Peace and Development Foundation; Chairman, Emerging Markets Forum; Former President of the Philippines*
10:15 – 10:30	*Presentation: Jack Boorman, Former Director of Policy Development and Review Department, International Monetary Fund (IMF)*
10:30 –11:00	Panel Discussion Werner Hermann, Director, Department International Research & Technical Assistance, Swiss National Bank Andrew Sheng, China Banking Regulatory Commission, Hong Kong Securities and Exchange Commission Cyrus Rustomjee, Director, Economic Affairs Division, Commonwealth Secretariat
11:00 – 11:30	Discussion / Q&A
11:30 – 11:45	Coffee Break
<u>11:45 – 12:10</u>	**<u>Session II – Impact on South Asia</u>** *Chair:* Xiaoyu Zhao, Vice President (Operations 1), ADB
11:45 – 12:10	Presentation of Background Paper on South Asia Manu Bhaskaran, Chief Executive, Centennial Asia Advisors
<u>12:10 – 01:00</u>	**<u>Session III – Impact on and Actions to be taken by India</u>** *Chair: A. Lahiri: Former Chief Economist of India*
12:10 – 12:45	*Discussants: India* Arvind Vermani, Chief Economic Adviser, Ministry of Finance, Government of India Amitabh Verma, Joint Secretary, Ministry of Finance, Department of Economic Affairs, Banking Division Shri Manas Ray, Executive Director, Securities and Exchange Board of India Surjit Bhalla, Chairman, Oxus Research and Investment of India

	Madhur Srinivasa, Director, Office of Regional Economic Integration, ADB
12:45 – 01:00	Discussion/ Q&A
01:00 – 02:30	**Lunch hosted by Xiaoyu Zhao, Vice President (Operations 1), ADB**
02:30 – 04:00	**Session IV – Impact on and Actions Taken by Bangladesh** *Chair: A. Lahiri: Former Chief Economist of India*
02.30 – 03.00	*Discussants: Bangladesh* Salehuddin Ahmed, Governor, Bangladesh Bank Faruq Ahmad Siddiqi, Chairman, Securities Exchange Commission Paul Heytens, Country Director for Bangladesh, South Asia Department, ADB
03.00 – 03:30	Discussion/ Q&A
03:30 – 03:45	Coffee Break
03:45 – 05:00	**Session V – Impact on and Actions Taken Pakistan** ***Chair: Juan Miranda, Director General, CWRD***
03:45 – 04:30	*Discussants: Pakistan* Syed Salim Raza, Governor, State Bank of Pakistan Riaz Riazaddin, Economic Adviser, Government of Pakistan Muhammad Ali Choudhary, Director, Research Department, State Bank of Pakistan Ramesh Subramaniam, Director, Central West Financial Sector, Public Management and Trade, ADB
04:30 – 05:00	Discussion/Q&A
05:00 – 05:15	**Transfer from ADB headquarters to hotel**
19:00 – 21:00	**Dinner Hosted by President Haruhiko Kuroda, ADB** ***Keynote Speaker: Makoto Utsumi, President and CEO, Japan Credit Rating Agency Ltd and Former Vice Minister of Finance, Japan***

DAY 2 – TUESDAY, 10 MARCH

08:30 – 09:00	**Transfer from hotel to ADB headquarters**
09:00 – 10:30	**Session VI – Impact on and Actions Taken by Nepal and Sri Lanka** *Chair: Shamshad Akhtar, Special Senior Advisor, ADB*
09:00 – 09:30	*Discussants:* Nepal Rameshore Prasad Khanal, Secretary, Ministry of Finance Deependra Bahadur Kshetry, Governor, Nepal Rastra Bank Barry Hitchcock, Country Director for Nepal, South Asia Department, ADB Private Sector
09:30 – 10:00	*Discussants:* Sri Lanka Ajith Nivard Cabraal, Governor, Central Bank of Sri Lanka Ginige Channa Ajith de Silva, Director General, Securities and Exchange Commission Richard Vokes, Country Director for Sri Lanka, South Asia Department, ADB Joseph Zveglich, Director, Macroeconomic and Finance Research Division, ADB Private Sector
10:00 – 10:30	Discussion / Q&A
10:30 – 10:45	Coffee Break
10:45 – 12:00	**Session VII – Impact on and Actions Taken by Bhutan and Maldives** *Chair: Kunio Senga, Director General, South Asia Department*
10:45 – 11:00	*Discussants:* Bhutan Daw Tenzin, Managing Director, Royal Monetary Authority of Bhutan Nima Wangdi, Director General, Ministry of Finance Juzhong Zhuang, Director, Economic Analysis and Operation Support Division, ADB

11:00 – 11:20 *Discussants:* Maldives
Ali Hashim, Minister, Ministry of Finance and Treasury/
Fazeel Najeeb, Governor/Chairperson, Maldives Monetary Authority/
Bruno Carrasco, Director, South Asia Country Coordination and Regional Cooperation, ADB

11:20 – 12:00 Discussion / Q&A

12:00 – 01:00 **Session VIII – Summary of Country Discussions**
Chair: Kunio Senga, Director General, South Asia Department, ADB

Discussants:
Ashok Sharma, Director, South Asia Financial Sector, Public Management and Trade, ADB
Bruno Carrasco, South Asia Country Coordination and Regional Cooperation, ADB

01:00 – 02:30 Lunch hosted by Messrs Kunio Senga and Juan Miranda

02:30 – 04.00 Session IX – Need for Long Term Actions – Regional Coordination

Chair: Rajat Nag, Managing Director General, ADB

02:30 – 03:30 Round Table Discussion

Bangladesh: Salehuddin Ahmed, Governor, Bangladesh Bank
Faruq Ahmad Siddiqi, Chairman, Securities Exchange Commission

Bhutan: Daw Tenzin, Managing Director, Royal Monetary Authority of Bhutan
Nima Wangdi, Director General, Ministry of Finance

India: Arvind Vermani, Chief Economic Advisor, Government of India
Amitabh Verma, Joint Secretary, Ministry of Finance, Department of Economic Affairs, Banking Division

Maldives: Ali Hashim, Minister, Ministry of Finance and Treasury
Fazeel Najeeb, Governor/Chairperson, Maldives Monetary Authority

Nepal: Rameshore Prasad Khanal, Secretary, Ministry of Finance
Deependra Bahadur Kshetry, Governor, Nepal Rastra Bank

Pakistan: Syed Salim Raza, Governor, State Bank of Pakistan
Riaz Riazaddin, Economic Adviser, Government of Pakistan
Javed Hamid, Senior Managing Director, Financial Services Division, International Executive Service Corps

Sri Lanka: Ajith Nivard Cabraal, Governor, Central Bank of Sri Lanka/
Ginige Channa Ajith de Silva, Director General, Securities and Exchange Commission

ADB/Guest: Madhur Srinivasa, Director, Office of Regional Economic Integration, ADB

Ashok Sharma, Director, South Asia Financial Sector, Public Management and Trade, ADB

Jack Boorman, Former Director of Policy Development and Review Department, IMF

03:30 – 03:45 Coffee Break

03:45 – 04:00 Wrap Up Session
Closing Remarks: Xiaoyu Zhao, Vice President (Operations 1), ADB

INDIVIDUAL COUNTRY CONSULTATIONS

04:00 - 05:00 *Kunio Senga, Director General, South Asia Regional Department, ADB*
Juan Miranda, Director General, Central and West Asia Regional Department, ADB

To be attended only by the respective Country Official Delegates.

05:00 – 05:15 **Transfer from ADB headquarters to hotel**

07:00 - 10:00 **Dinner hosted by Rajat Nag, Managing Director General, ADB**

FORUM REPORT

Introduction

The ADB South Asia Forum on the Impact of Global Economic and Financial Crisis, held in Manila on March 9-10, 2009, was the first of a series of four to be convened by the ADB in response to the global financial and economic crisis.

This first forum was to provide a platform for South Asian countries to review how each of them are being affected by the global crisis and the measures that are being taken to preserve financial stability, stimulate growth and ensure social protection in the face of a world economic recession. The next steps would be for the group of senior officials from national governments and regulatory agencies to deliberate with experts from the Asian Development Bank, regional agencies and international research organizations on additional policies to cope with the current crisis and how they should go about taking long term policy measures to build up the resilience and strength of their economies.

The Forum began with an Opening Session presided by President Haruhiko Kuroda of the ADB and a Keynote Address on "Asia in the New Global Financial Architecture" by Mr. Michel Camdessus, Former Managing Director of the International Monetary Fund and currently the Honorary Governor of Banque de France and Co-Chair of the Emerging Markets Forum. President Fidel Ramos (Chairman, Ramos Peace and Development Foundation; co-Chair of the Emerging Markets Forum, and Former President of the Philippines) was also present.

Following the Opening, the Forum proper was divided into nine sessions covering three main themes:

1. **Global Economic and Financial Crisis and Impact on Emerging Markets:** There were two sessions to provide the international and regional economic backdrop, for which two background papers prepared by the Centennial Group were presented:
    - "The Current Crisis: Its Origins, Its Impact and the Needed Policy Response" by Claudio Loser; and
    - "The Impact of the Global Economic Slowdown on South Asia" by Manu Bhaskaran.

2. **Country Impact and Actions to be Taken**: There were six sessions of country presentations led by senior officials from India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan and the

Maldives. The individual country sessions were followed by a summary session on all countries together.

3. **Need for Long term Actions – National, Regional Coordination and Role of Multilaterals:** A roundtable session involving individual South Asian countries, and speakers from the private sector and the ADB.

The highlight of the **Closing Session** was an address by Mr. Arun Shourie, Member of Parliament, India and Former Minister of Telecommunications, Commerce and of Privatization who shared his perspective on the social implications of the financial crisis in South Asia.

Welcome Remarks by President Haruhiko Kuroda

In his Welcome Remarks at the Opening Session, ***President Kuroda*** of the ADB expressed his concern about the four inter-related impacts of the global economic downturn on Asia, these being:

1) The impact of the economic slowdown on the exports of Asian countries across the entire value chain and its consequences on employment and GDP growth.
2) The impact on the financial system as a result of outflow of foreign direct investment from Asia's financial and capital markets, which in turn is depressing domestic equity markets and contributing to the tightening of lending policies.
3) The impact on liquidity in domestic financial markets. The constraints on credit availability will be even more constrained for the lower end of the market, namely credit for labor-intensive small and medium enterprises and micro-enterprises.
4) The potential impact, though not fully evident yet, on informal social safety nets by virtue of reduced remittances received from overseas migrant workers, whose employment are being affected by the economic slowdown and capital expenditure cutbacks in the host countries.

In light of these impacts, the President emphasized that the strides gained in poverty alleviation must not lose momentum. It is important to protect the most vulnerable segments of our societies through support for the poor and public spending that creates jobs while preserving macroeconomic stability.

Multilateral development banks on their part must work together to ensure that developing countries in Asia have sufficient access to financing through a mix of loans, grants and credit guarantees to support critical areas of infrastructure, education and health. In 2009, ADB is stepping up its operations by several billion dollars from the original budget of US$12 billion to assist its developing member countries affected by the crisis by employing a combination of measures, which includes targeted lending, greater use of guarantees and enhanced co-financing. However, for ADB to deliver its mission of poverty reduction in Asia more effectively, it is seeking an immediate and substantial capital increase at the upcoming ADB Annual Meeting in Bali in May 2009.

Keynote Address by Michel Camdessus on "Asia in the New Global Financial Architecture"

Mr. ***Michel Camdessus*** acknowledged in his Keynote Address that the current global crisis is the most severe seen in our lifetime and has not yet bottomed out. Instead of being caught up in the rhetoric of despair, it is better to ask ourselves how we can contribute towards recovery and recognize that we have to not only react quickly but also to do it in a coordinated way. Those who are quick to respond will benefit more, while coordination amongst countries will yield significant positive effects.

The cost of the crisis has been tremendous in human and financial terms. It need not have happened if the lessons of the 1997 Asian crisis had led to the adoption and vigorous implementation of reform of the international financial architecture. We must now intensify work on designing and putting in place a new global financial architecture with the instruments to making the recovery a lasting one. The sheer severity of the present situation should open the eyes of world leaders to establish right away a new financial architecture.

Building Blocks of a New International Financial Architecture:

The new international financial architecture can be a simple scheme comprising three basic building blocks in the form of a brand new IMF, a new body (Council) to make major policy decisions, and a new governance arrangement under which the emerging markets would have a much greater weight.

Reform of the IMF would require a new mandate, which allows the IMF to undertake surveillance of all financial developments and to initiate, coordinate and follow up on new regulations in order to prevent abuses and maintain financial stability. The amendments of the Articles of Agreement should seek to establish an institution that is founded on the principles of universality, legitimacy, fairness of representation, subsidiarity, efficiency and accountability.

The magnitude of the responsibilities entrusted to the new IMF justifies a corresponding review of its governance structure to ensure all countries are represented in all levels of governance. This means the G8 should relinquish its present self-attributed responsibilities to a Global Financial and Monetary

Governance Council as the highest-level decision-making body. It could start with 25 members (Ministers of Finance and Governors) but there should be an understanding that this number must be reduced to a more efficient number as and when the situation permits.

Finally, there should be an agreement that would improve the voice and representation of the fast growing emerging countries. In particular, Asia should be assigned a much greater weight than the IMF. Credibility of the Fund depends on realigning the powers of the institution as soon as possible, no later than 2010.

On the division of work between the Financial Stability Forum and the IMF, this should be clearly defined and coordinated.

Similar changes in the governance and operations of the World Bank, the Asian Development Bank and other multilateral agencies should also be adopted in the spirit of subsidiarity.

The ADB can play an important counter-cyclical role to mitigate the impact of the crisis on Asia by providing budgetary support to governments, emergency liquidity, trade financing and funding of infrastructure. ADB has made tremendous contribution to the development of Asia and increasing its capital would represent good investment of scarce financial resources.

Role of Asian Countries:

Asian countries must play their part in ensuring that the new financial architecture meets the challenges of a globalized world. To do this, the essential conditions to be fulfilled are:

1. Developing and emerging countries from Asia must take ownership of this new architecture and play their full role at all levels of governance, which includes:
   - Uncompromising surveillance;
   - Excellence in conduct of mutual policies and regional cooperation;
   - Active contribution to global coordination; and
   - Generous solidarity.
2. Active and forceful use of its voting powers in the World Bank and IMF and the proposed Global Governance Group.
3. Pursuit of regional cooperation in various forms.
4. Active participation in the Financial Stability Forum and the BIS.
5. Continued improvements in national regulatory and supervision systems.
6. Active role in correcting global macroeconomic and structural imbalances.
7. Contribute generously to rebalance the financing of the global system, in particular the poorest countries.

With that, Asia has all the needed reasons and experience to contribute towards building a new financial architecture.

Session I. Global Economic and Financial Crisis and Impact On Emerging Markets

Chair: ***Makoto Utsumi*****,** *President and Chief Executive Officer, Japan Credit Rating Agency Ltd., Former Vice Minister of Finance, Japan*

Presentation: **The Current Crisis: Its Origins, Its Impact and the Needed Policy Response** by ***Jack Boorman***, *Member of Advisory Board, Emerging Markets Forum; Former Director of the Policy Development and Review Department, IMF*

In his presentation, Mr Boorman noted that there was broad agreement that the current global crisis had its roots in:

- The "search for yield" and a weakening or even the lack of understanding of risk management during the expansion phase of the credit cycle from 2002 to 2006;
- The international fragmentation and lack of harmonization of financial supervision and regulation in the face of rapid innovation in the financial markets; and
- Weaknesses in certain aspects of surveillance conducted by the IMF.

The crisis manifested itself initially in the sub-prime mortgage market in the U.S. – which quickly spread to Europe, culminating in the breakdown of the market for credit default swaps – a huge, unregulated, and thoroughly opaque market; and in the general collapse of the markets for securitized instruments across the global financial system. It was aggravated by the policy missteps in handling the crisis, especially in dealing with the problems at Lehman Brothers, which effectively froze the interbank market.

Forces Underlying the Crisis:

Behind all these developments were several critical underlying forces:

- The first was the global imbalances that were permitted to persist and to increase over the last decade – flooding the global financial system with liquidity. These imbalances were the result of fundamental distortions in the macroeconomic underpinnings of some of the largest economies in the world – not least the excessive saving rates in much of Asia and in some of the oil exporting countries, and the fiscal deficits and inadequate private savings rates in the United States. Adjustment is going to be difficult, painful, and possibly prolonged.
- The second enabling force was the inadequate regulation and supervision in national regulatory and supervisory regimes and in the failure of the credit rating agencies to discharge their most fundamental fiduciary responsibilities. Much of this stemmed from the

persistent trend towards deregulation in the United States, from the competitive pressures that undermined prudent financial risk management in some of the major global financial centers; and from the complexity of some of the financial innovations of this period. Notwithstanding the increased complexity of the global financial markets, much of the regulatory failure resulted from ignoring the basics of demanding basic transparency in the financial system. It was reflected in inadequate capital and liquidity requirements that failed to keep up with the innovations that were taking place in the banks and in the financial system more generally.

- Many of the ensuing problems stemmed from a simple lack of attention to the incentives that were permitted to build in the system. The result was that the system went from "exotic" to "toxic" within short time.
- The final enabling factor behind the current crisis was the inadequacy of the surveillance conducted by the IMF and other global official financial institutions. In the lead up to the current crisis, the Fund's surveillance – at both the bilateral and multilateral level – had been less effective than the evolving situation demanded. To strengthen its surveillance, the Fund must look both to its governance structure and to the content and coverage of its surveillance.

The sharp and rapid deterioration in the real sector has been at an alarming pace in the past six months. GDP in the fourth quarter of 2008 fell at an annualized rate of over 20 percent in South Korea, almost 13 percent in Japan, over 8 percent in Germany, nearly 6 percent in the U.K. and over 6 percent in the revised estimate for the U.S. The figures for industrial production in many of these countries were even worse; so were the decline in exports in many countries, including those in Asia.

These developments have disproved the proposition that the emerging market countries had de-coupled from the major industrial countries and that they would be able to withstand a slowdown or recession in those countries. As was also discussed in an earlier Emerging Markets Forum (in Hanoi), the explosion of global trade – the major force in the rapid growth of the emerging economies of the last few decades, together with the design of the world's supply chains, and the ever-increasing integration of financial markets had, in fact, increased the coupling of the emerging market economies and the developing countries with the industrial world.

Many emerging market countries were being hit on both their exports - raising prospects of enlarged current account deficits - and in their access to foreign capital. Lower rated borrowers, in particular, faced serious refinancing and default risks. Emerging market economies facing the need to refinance a large amount of maturing international debt were confronting investor risk aversion, competition from both large and small industrial countries that will be issuing an unprecedented volume of government and government-guaranteed debt and higher spreads on their debt issuances.

In this environment, net private capital flows to emerging market economies - which totalled US$929 billion in 2007 - were forecast in January by the IIF to collapse to US$165 billion in 2009. At the same time, remittances of earnings by foreign workers, which amounted to well over US$100 billion in Asia in 2008, were set to fall sharply with dire consequences for the well-being of many millions of households throughout the region. A similar impact will come from the already declining receipts from tourism in many countries in the region. Official lenders, including the IMF, will have to build up their capacity to meet these growing financing gaps.

Policy Actions Needed for Financial Recovery:

First the immediate actions:

- Most important is to stabilize the banking system – especially in the U.S. and Europe – and to restart the flow of credit. This will require still greater clarity in policy actions and much greater transparency in the implementation of those policies.
- To halt the destructive capacity of credit default swaps in order to ease the pressure on the credit and stock markets.
- Equally important is to establish the institutions and the procedures to assure that the stimulus packages that have been announced begin to impact spending as soon as possible and that spending is well directed towards reversing the decline in activity and in employment.
- Related to this, there will be a need to monitor the impact of these spending packages.
- Along the same lines, the reactions of the bond and credit markets to the massive increase in deficits and public debt that will accompany this spending need to be assessed on a continuing basis. Surplus countries with strong fiscal positions and abundant reserves, including those in this region, are obviously in the best position to contribute to this global effort. Already heavily indebted countries, as well as those with weak external positions should avail themselves of funding available from the IMF and from the multilateral and regional development banks to help them maintain or increase spending where appropriate, but the contribution they can make to global stimulus will be limited.
- A mechanism should be established immediately to monitor protectionist measures introduced or intensified by any country. Perhaps the IMF and the WTO could cooperate to quickly put such an information system in place. Perhaps a "name and shame regime" should be employed to make countries hesitate when contemplating such measures.

- There are other actions that should be taken as a matter of urgency:
    - There should be an immediate and large allocation of SDRs by the IMF. Importantly, there should be no "stigma" attached to receipt of these SDRs by a country.
    - There should be additional borrowing agreements put in place along the lines of that recently agreed between the IMF and Japan. There should also be an appeal to participants in the GAB and NAB to increase their commitments, and encouragement of other countries to join in those arrangements. The cumulative amount of resources secured through the bilateral agreements and the GAB/NAB needs to be several times the resources currently available to the Fund – not just the doubling of those resources being called for by some.
    - The Fund's newly created short-term liquidity facility – which has yet to be used – needs to be modified. Its maturity - currently only 3 months, renewable twice - needs to be lengthened; the access limit of 500 percent of quota should be eliminated; and countries should be permitted to request support under the facility on a precautionary basis.

There are other measures that cannot be done immediately but should be set in motion as soon as possible. These include:

- Substantial reform of national regulatory and supervisory systems that oversee financial institutions and markets. These reforms need to include both macro and micro prudential regime – the former looking at systemic vulnerabilities and the latter regulating and monitoring risks in individual institutions. Major changes in the rules governing transparency of all actors in the financial system need to be designed and implemented.
- IMF quotas – its permanent financing mechanism - should be increased substantially. If the IIF forecast of private flows to emerging market countries turns out to be even roughly correct, such flows would have declined by over $750 billion between 2007 and 2009. The view that was gaining some ground a few years ago that the Fund would not be a lending agency in the future has been shown to be fundamentally wrong. There will be crises in the future and the global system needs an institution that is fully capable of meeting the potential financing needs of its members. A tripling of current quotas could be necessary.
- A review of IMF quotas should begin with a firm commitment that the resulting distribution of quotas will result in votes for all member countries that reflect their place in the global economic and financial system. In addition, there should be a fundamental change in the governance of the Fund, including other changes in representation in the executive board and in the IMFC.

- Lastly, changes need to be made in both the content and the procedures for Fund surveillance – the institution's most important function. In particular, there needs to be a better coordination of the Fund's traditional macroeconomic focus with its increasing capacity for financial sector analysis. The initiative on enhancing the collaboration between the IMF and the Financial Stability Forum should be pursued in a realistic and pragmatic fashion that takes account of the mandate and the capacities of each. Also, for surveillance to be truly effective, it must be evenhanded. Greater independence in the conduct of surveillance is required, and this too will require significant changes in the governance structure of the institution.

On the issue of global governance, the International Monetary and Financial Committee (IMFC) of the IMF is the most appropriate de facto governing body for decision making on policy actions. It is universal through its constituency structure and it operates under international law, i.e., the Articles of Agreement of the Fund. The G-20, which has arbitrary membership, should restrict its role to giving the political push to some of the initiatives at the principles level, and leave the specifics to the IMFC.

First Discussant – *Werner Hermann*, *Director, Department of International Research and Technical Assistance, Swiss National Bank*

The financial aspects of the crisis in the Western economies were discussed in three parts:

- Causes and consequences,
- Classification of interventions by the authorities, and
- Evaluating the effectiveness of the interventions.

The causes of the crisis included excessive capital inflows, over-investment in housing followed by a fall in asset prices and subsequent flight to quality.
The consequences of these developments were a severe credit crunch, reflecting problems of liquidity, insolvency and obsolete technology.

Since August 2007, a series of interventions were undertaken by the authorities in Europe and the United States, beginning with the European Central Bank providing supplementary refinancing operations and the Swiss National Bank broadening its range of acceptable collateral. Other forms of interventions to address the problems of liquidity, insolvency, technology and credit crunch included monetary policy easing, emergency liquidity assistance, credit easing, government lending, capital injection, government guarantees, nationalization and a ban on short selling by the SEC and the FSA in UK. However, it is still too early to gauge the effectiveness of this mix of interventions.

Second Discussant – *Cyrus Rustomjee,* *Director, Economic Affairs Division, Commonwealth Secretariat*

The Commonwealth has a total population of 2 billion people living in 53 countries, of which 5 are G20 members, 32 are small states.
The depth and scale of the crisis transmitted to Commonwealth countries differ among the 4 regions, namely, South Asia, the Caribbean, the Pacific and Africa. In examining South Asia, it would have been ideal to separate those countries which have high reserves and fiscal space. But delineation is not possible. Generally the transmission effects were:

- Severe declines in trade and services,
- Contractions in savings,
- Sharp declines in remittances, and
- First round effects on the fiscal sector, especially those with large foreign bank ownership.
- Second round effects on the banking sector resulting in credit being squeezed.

The many challenges facing South Asia include the following:

- Limited fiscal space to effect countercyclical spending
- Emergency liquidity requirements
- Short term funding.

Among the policy options are:

- Deepening regional cooperation
- Strengthening of internal markets to build resistance to future crises,
- Identifying new markets.

Session II. Impact of the Crisis On South Asia

Chair: ***Xiaoyu Zhao*****,** *Vice President (Operations 1), ADB*

Presentation: Impact of the Global Economic Slowdown on South Asia by ***Manu Bhaskaran***, *Chief Executive, Centennial Asia Advisors*

A background paper with the above title was prepared by the Centennial Group to facilitate discussions at the Forum. The issues that were highlighted in the presentation of this Background Paper are summarized below.

1. The worse than expected economic slowdown in the United States and Europe and the patchiness of ongoing efforts to resolve the financial problems of G3 countries will intensify the spread of the global crisis to Asian economies. Hence policy makers in Asia cannot be complacent about being less exposed to the global turmoil.
2. The crisis poses substantial risks to emerging market countries, operating through multiple transmission mechanisms. They will be affected in several ways:
    - **Trade**: the volume of exports of goods and services is contracting in most open economies as global demand falls.
    - **Financial flows**: Flows of portfolio capital to emerging markets have fallen sharply because of increased risk aversion in developed countries.
    - **Remittances**: Remittances are coming under pressure as major labor-importing economies, including the Middle East, are beginning to retrench foreign workers following the slowdown in domestic investments.
    - **Commodity prices**: With the spread of global recession, commodity prices have fallen sharply, reducing incomes to households in emerging countries which export such commodities
    - **Foreign direct investment**: As global companies' perception of the risks and rewards of investing income become more cautious and as raising funds for investment becomes more difficult, foreign direct investment in emerging markets will also fall
3. A prolonged economic slowdown in G3 countries will also unleash a different set of problems and risks for emerging markets:
    - Economies with high levels of maturing external debt will face difficulties of re-financing this debt and at higher costs.
    - There are the dangers of protectionism gaining ground, although this may be in disguised forms of trade distortions.
    - The risks of global deflation could well rise if credit mechanisms remain impaired, GDP growth of the major economies remains below potential for a prolonged period and asset prices fall across the board for many asset classes.

4. The policy response in South Asia thus becomes crucial. In the short term, policy should be directed at mitigating the impact and possible risks of the global crisis through a combination of monetary, fiscal and other measures. In the longer term, policy actions should promote faster economic growth and improved resilience to future global economic shocks, such as increased diversification of the economic base, stepped up infrastructure development and increased regional cooperation and coordination.

Presentation: ***Harinder Kohli,*** *Chief Executive, Emerging Markets Forum, Centennial Group*

He observed that the transmission mechanisms that have been identified as feeding into emerging markets are valid for most developing countries, including Pakistan.
Pakistan's economy was at a critical juncture when it became the first country in the region to seek a US$7.6 billion Stand-by Arrangement from the IMF in November 2008 to support its economic stabilization program. Besides the problem of high inflation, a depreciating currency and declining foreign exchange reserves, it faced social risks because of the decline in external demand for its exports and uncertainty regarding the prospects for workers' remittances.

The resolve of the Pakistani authorities to observe the IMF program's quantitative performance criteria has produced positive results, paving the way for Pakistan to seek further financial support from the international community (at a Donor Meeting scheduled for March/April 2009) for the purpose of economic stabilization, mobilization of resources for social protection and laying the basis for high and sustainable future growth. There is much for the countries in South Asia to learn from Pakistan's approach to confronting the global crisis.

Comments by **the Chair**

The background paper has clearly brought out the various transmission channels though which South Asian economies are being affected – decline in trade, financial flows, FDI, and remittances; fluctuations in commodity prices; and difficulties in re-financing external debt:

- The Governments in South Asia have been pro-active in taking monetary and fiscal measures to contain the adverse effects of this crisis. However, caution needs to be exercised to ensure that stimulus measures do not push up fiscal deficits to unmanageable levels, which could potentially jeopardize the long-run growth prospects of these economies.

- There is also need to focus on the long-term measures that have to be taken to (a) ensure that South Asian economies are in a position to bounce back once the global economy revives, and (b) to enhance their resilience to future global economic shocks.
- In this context, it is encouraging to note from the background paper that South Asia is not faced with a structural breakdown, but that current conditions are symptomatic of a cyclical downturn. This means that the region has the opportunity to bounce back stronger if concerted efforts are made now. Further diversification of the economies and continuing emphasis on infrastructure development are likely to yield dividends in the long run.
- The tremendous potential for enhancing intra regional trade and cooperation within Asia as a whole also needs to be tapped. This will not only help generate growth and employment, but also create balanced international trade flows
- Sub-regional transport infrastructure should be improved on a priority basis to support a region wide supply chain
- On the emphasis in the paper for greater coordination and regular dialogue among the region's central banks, countries in the region have so far refrained from protectionism and competitive devaluation since such policies would be self-defeating
- The paper also emphasized the need to enhance cooperation and coordination in financial stabilization through measures such as swap arrangements
- The development challenges facing the region – high levels of poverty, poor social indicators, severe infrastructure bottlenecks, inefficiencies in delivery of basic public services – are daunting. A slowdown in growth in South Asia would have adverse implications for the poverty reduction agenda. It is therefore, critical that the South Asian economies weather the current global economic and financial crisis well, and also work towards building up their long-run resilience and strength.

The views and suggestions of all the experts during the country-level sessions would be invaluable to the ADB for synthesizing them into practical policy measures for addressing the unprecedented challenges that face emerging today. These issues include the following:

- What additional short-term measures are required to be taken by countries of South Asia to contain the adverse fall-out of this crisis?
- How should they go about taking long-term measures and enhancing regional cooperation?
- What are the relative merits and demerits of different policies?
- How can ADB support the Governments?

Session III. Impact and Actions to be Taken : India

Chair - *A. Lahiri*, *Executive Director, ADB*

Discussants:

Arvind Virmani, *Chief Economic Adviser, Ministry of Finance, Government of India*
Surjit Bhalla, *Chairman, Oxus Research and Investments of India*
Sri Mohanti, *Executive Director, Reserve Bank of India*

India: Summary of Issues Discussed:

1. India performed exceptionally well in the last five years since 2003. However, this was a period which presented the authorities with the challenges of transiting from the high growth period and threatened overheating, to the deceleration period evident in the latter part of 2008.
2. After growing at a steady pace of more than 9% since FY 2005, the Indian economy was now showing signs of slowing down as a result of the current global economic crisis. Several leading indicators of GDP growth - export performance, automobile sales, credit off-take, and advance tax collections -have weakened since October 2008.
3. The global crisis was affecting India mainly through the following transmission channels:
   - Financial (reversal of capital inflows, depressed valuations, raising capital cost and lowering incentive to invest);
   - Trade (decline in export of goods and services, job losses in export sectors);
   - Decline in remittances; and
   - Fall in FDI inflows.
4. In 2008 itself, India was subjected to major shocks on the trade and capital account front:
   - The sharp increase in oil and commodity prices, which enlarged the current account deficit in the 1st half of 2008 and spiked inflation.
   - The huge increase in capital inflows (over 9% of GDP) at the beginning of the year and its sharp reversal towards year-end, putting pressure on the currency and causing the Indian Rupee to reverse its earlier appreciation.

In response to these shocks, India reversed its fiscal policy stance from one of fiscal consolidation in recent years (to contain its already large fiscal deficits) to one that was accommodative of fiscal stimulus packages to alleviate the impact of the global crisis.

There was an active debate among the discussants as to what constitutes a fiscal stimulus – is it to be measured in terms of the fiscal deficit vis-à-vis the

FRDM benchmark of 3%. Is it the incremental change over the fiscal deficit norm or is it measured in terms of the subsidies content?

There were also some differences of views among the discussants on the exchange rate policy to be adopted in India.

Concluding Remarks by the Chair

There are as yet no clear answers on the future prospects for India apart from expectations that on balance, India is expected to weather the current economic storm better than many other countries.

Moving forward, the additional short term measures as emphasized in the Background Paper need to focus on:

- Further infusion of liquidity and rate cuts;
- Regulatory changes – such as simplification of ECB requirements and FDI guidelines;
- Creating more fiscal space for states; and
- Improve implementation of the announced fiscal stimulus measures.

Over the long-term, the Government would have to focus on:

- Restoring the process of fiscal consolidation – rationalize subsidies, strengthen tax administration, enhance the efficiency of public spending;
- Regulatory changes to facilitate greater private sector investment, strengthen corporate governance, and continue with simplification of procedures and processes so that the overall transactions costs of doing business in India goes down;
- Continued focus on infrastructure development – including through PPPs; and
- Regional cooperation to foster aggregate demand. Develop cross-border transport infrastructure to support a region-wide supply chain.

Session IV: Impact and Actions to be Taken: Pakistan

Chair: ***Juan Miranda***, *Director General, Central and West Asia Regional Department, ADB*

Discussants:

Syed Salim Raza, *Governor, State Bank of Pakistan*
Javed Hamid, *Senior Managing Director, Financial Services Division, International Executive Service Corps*
Riaz Riazaddin, *Economic Adviser, Government of Pakistan*

Pakistan: Summary of Discussions

1. To date, Pakistan has been moderately affected by the global economic crises. The transmission channels have mainly been reduced demand of exports, and some softening of demand for expatriate labor.

2. The impact has been exacerbated by the softening of domestic economic growth and imbalances on fiscal and balance of payments account

3. Economic Trends:
   - During the period 2000-2007, Pakistan's economic growth performance was strong, averaging around 5%, p.a. with low inflation and a low budget deficit.
   - Pakistan's macroeconomic situation deteriorated significantly during Fiscal Year 2007/08 (beginning July 1) and in the first four months of 2008/09 because of adverse security developments, large increases in import prices (oil and food), and the global financial turmoil
   - Delays in the passing through of higher energy prices to consumers led to an increase in the fiscal deficit to 7.4 percent of GDP in 2007/08, from 4.3 percent in 2006/07. Monetization of the higher fiscal deficit fueled inflation, which reached 25 percent in October 2008. Against this background, real GDP growth slowed to 5.8 percent in 2007/08, the current account deficit widened to 8.4 percent of GDP, and gross international reserves fell to a critically low level of $3.4 billion (less than one month of imports) at end-October 2008.

   The Government launched an economic stabilization program with the support of a US$7.6 billion Stand-By Arrangement (SBA) approved by the IMF in November 2008. The two objectives of the program were:
   - To restore overall economic stability and confidence through a tightening of macroeconomic policies; and

- To do so in a manner that ensures social stability and adequate support for the poor during the adjustment process.

The Government's program for the coming 24 months envisages a number of additional steps:

- The fiscal deficit, excluding grants, will be brought down from 7.4 percent of GDP in 2007/08 (starting July 1) to a more manageable 4.2 percent in 2008/09 and 3.3 percent in 2009/10.
- The State Bank of Pakistan (SBP) will act on monetary policy to build its international reserves, bringing down inflation to 6 percent in 2010, and eliminate central bank financing of the government.
- Expenditure on social safety net will be increased to protect the poor both through cash transfers and targeted electricity subsidies.

4. Channels of Impact of the Crisis:

On **trade**, value added textile sector is likely to be adversely affected as demand for these goods softens in the more developed economies. In turn, this may lead to adverse impact on employment, growth and the fight against poverty.

Remittances sourced through the Gulf countries accounting for over two-thirds of total remittances to Pakistan from expatriate workers are likely to be adversely affected depending on the extent of closure/delay on on-going construction projects in the Middle East, as international oil prices remain low.

5. The way forward:

Effort should go towards positioning Pakistan to meet the global challenges:

- On **trade**, the Government has started a dialogue with the representative domestic and international bodies to maintain market access and to provide intra-regional trade linkages. Targeted export-finance scheme may become necessary.
- On **remittances**, the existing social safety nets are being strengthened and focus sharpened.
- On **infrastructure development**, especially in the area of power and gas, there is potential for greater public-private partnerships (PPP). Because of the lead time needed, PPP should be expedited.
- Pakistan has little fiscal and monetary space for a stimulus package due to its resolve to maintain self-discipline. Therefore multilateral flows become all the more important as a source of

funding. On international aid, the Friends of Pakistan forum is likely to meet soon to formalize a multi-year assistance package. Separately, efforts are afoot for the multi-million dollar, multi-year economic assistance package to be provided by the United States.

- Currency swap facilities with central banks should also be considered.
- Local banks have a very low exposure to toxic assets. However, since the economy cannot be decoupled from the international economy, strengthening of prudential guidelines and revisiting capital adequacy ratios may become necessary.

Session V. Impact and Actions to be Taken: Bangladesh

Chair: ***A. Lahiri,*** *Executive Director, ADB*

Discussants:

Paul Heytens*, Country Director for Bangladesh, South Asia Department, ADB*
Faruq Ahmad Siddiqi*, Chairman, Securities Exchange Commission, Bangladesh*
Ashok Sharma*, Director, South Asia Financial Sector, Public Management and Trade, ADB*

Bangladesh – Summary of Issues Discussed:

1. So far, Bangladesh has been relatively unaffected by the global economic crises, the contributory factors being a long track record of sound macroeconomic management, relatively robust economic performance coupled with relatively limited exposure to international financial markets, capital outflows and tourism; and limited vulnerability of the financial sector.
2. Strong Economic Trends:
   - Growth has been steady, averaging around 6.2% over the period 2004-2008. The projection for 2008-09 is 6% - which is only marginally lower.
   - Inflation has eased with the decrease in global energy prices.
   - Imports are cheaper with the fall in global commodity prices and this will benefit consumers considering that Bangladesh imports some essential goods.
   - The agriculture sector has recorded robust performance, with growth expected to expand in 2008/09. Bumper harvests have been reported for important crops like boro rice, maize, wheat and potato.
   - The services sector has continued to perform well especially in the segments of wholesale trade, retail trade and transport and telecommunications in 2008-09. There has also been noticeable growth in mobile phones and healthcare.
   - The political climate in Bangladesh has stabilized following the elections of December 2008, enhancing its investment attractiveness to foreign investors.
3. Channels of Impact of the Crisis:

   Though marginal, the major channels of impact of the global crisis on Bangladesh are trade, remittances and international aid.
   - On **trade,** the export industry has been poorly diversified and dominated by low-cost garment exports, mainly to the G7 countries including the United States and Europe, which account for 70% of

these exports. These may not be drastically reduced in the short term. Being a petroleum and food-importing country, the reduction in the prices of these commodities has eased budgetary problems but this may just be a short-term relief.

- **Remittances** accounted for 9.7% of the GDP with about 1 million Bangladeshi workers employed abroad out of a total population of 140 million. The two zones of migration are to the US/ UK zone (where they are engaged in the hospitality industry) and to the Middle East where construction and oil production projects offer employment. As these zones are affected by the crisis, inward transfer flows will slow with concomitant job losses for Bangladeshi workers.
- **International aid:** The economy relies on international aid and any slowdown in grants would set back its poverty alleviation strategy.

4. **Way Forward: Short-term Measures**
   - On **trade**, a high level committee constituted by the Finance Ministry is likely to look into the issue of cash incentives for apparel exporters.
   - On **remittances**, initiatives have been taken towards agreements with other countries like Libya, Jordan and Bahrain for manpower exports.
   - On **international aid**, the country would need to explore ways to augment investment needs to meet current requirements. Foreign direct investment had never been significant in Bangladesh.

5. Way Forward: Long-term Measures

The relatively low level of volatility in the Bangladesh economy offers the country an opportunity to consolidate efforts towards long-term measures of promoting sustainable and higher levels of growth.

While the insulation of Bangladesh from the outside world has been its major source of strength, the question to ask is "What has Bangladesh lost in terms of foregone growth?" One view was that insulation has hindered Bangladesh from becoming a middle-income country enjoying 8-9% growth as opposed to average growth of 5-6% in previous years.

Among the suggestions for long-term measures were the following:

- Proactiveness in seeking labor deals in the Middle East on the one hand and on the other, improving the banking infrastructure to absorb the remittances by foreign workers.
- Programs to promote skills training as a measure to raise the earning potential of workers before they are sent abroad.
- Diversify its export destinations.
- Use its experience in microfinance for the poor to improve the financing of small and medium enterprises (SMEs).

Session VI. Impact and Actions to be Taken: Nepal and Sri Lanka

Chair: ***Shamshad Akhtar,*** *Special Senior Advisor, ADB*

Nepal:

Discussants:

> ***Rameshore Prasad Khanal****, Secretary, Ministry of Finance, Nepal*
> ***Deependra Bahadur Kshetry****, Governor, Nepal Rastra Bank*
> ***Barry Hitchcock****, Country Director for Nepal, South Asia Department, ADB*

Nepal: Summary of Discussions

1. Similar to the situation in Bangladesh, Nepal has had limited impact from the global crisis because of its relatively low exposure to the global economy and a fairly insulated financial sector.
2. **Channels of Impact of the Crisis**:
   The primary channels of impact of the global crisis on Nepal were trade, tourism, and international aid / foreign direct investment.
   - On **trade,** the bulk of Nepal's exports (63%) are to India, consisting of jute products, polyester yarn, vegetable ghee or oil, thread, textiles, zinc sheets and juices. These exports were not expected to contract. The remaining 37% of exports to the rest of the world, comprising ready-made garments, *pashmina* and woollen carpets, may decelerate. On balance, a mild slowdown in exports was expected.
   - **Tourism** has been an important industry in Nepal, with earnings in the sector contributing to 1.8% of the GDP. There were indications that tourist arrivals have contracted. In January 2009, there was a decline of 15.8% in arrivals over the year, including a decline of 17.6% in arrivals from India.
   - **Remittances** will be a possible source of financial impact as there were indications that outgoing workers were declining in numbers, and returnees from the Middle East and South East Asia were rising.
   - **International aid and foreign direct investments:** Foreign direct investments including committed investments in key sectors like hydropower, tourism, and agriculture may suffer with the dampening of the global investment climate. International aid may also be directed to other emerging pressing needs.

3. **Way Forward: Short-term Measures**
   - Given the marginal impact of the global crisis, the pressing need for

short term measures has not yet arisen in Nepal. Should the need arise; the economy has the capacity to undertake short-term measures.

- The economy would be in a position to manage fiscal stimulus packages, given that the fiscal deficit is at a prudent level of 2% of the GDP at present.
- Foreign exchange reserves are at a high level, sufficient to cover 9.1 months of merchandise exports as in 2008.
- Inflation is linked to a large extent to the inflation situation in India, its main supplier of goods. So far, inflation was under control.

4. **Way Forward: Long-term Measures**
    - The relative short term stability in the Nepalese economy offers the country an opportunity to consolidate efforts towards long term measures of promoting sustainable infrastructure growth, creating employment and removing bottlenecks to business investment.
    - Enhancing the productivity of the manufacturing industry with pro-industry reform could be an important action area considering that manufacturing value added in GDP grew by a mere 0.2% in 2007-08.
    - Infrastructure development, especially hydro-power development could result in huge benefits for the country and the region as a whole. Currently, Nepal harnesses only 561 MW of its 83,000 MW of hydro electricity potential.
    - On foreign investment, the country would need to explore ways to augment investment needs to meet current requirements.

Concluding Remarks by the Chair:

- It was clear that Nepal had weathered the global crisis quite well. However, given its underlying vulnerabilities, challenges will inevitably surface.
- Tourism has been impacted. But a greater potential threat is from remittances, which has been the real buffer of the balance of payments and reserves buildup.
- Unemployment is also a real threat.
- Inflation is also a threat and requires effective monetary management.
- Nepal has fiscal space to undertake greater public spending.
- It is important for Nepal to continue with the broader objective of macroeconomic management while addressing structural issues of raising productivity. Resolving power shortages in the country is key to the productivity issue.
- In the banking sector, an urgent step is to restructure and consolidate its banks, including the state-owned banks.
- Steps should also be taken to modernize the regulatory architecture

so as to develop good practices in managing the economy, especially in the real estate sector.

Sri Lanka:

Discussants:

Ajith Nivard Cabraal*, Governor, Central Bank of Sri Lanka*
Ginige Channa Ajith de Silva*, Director General, Securities and Exchange Commission, Sri Lanka*
Richard Vokes*, Country Director for Sri Lanka, South Asia Department, ADB*
Joseph Zveglich*, Director, Macroeconomic and Financial research Division, ADB*

Sri Lanka: Summary of Discussions

The Sri Lankan economy experienced stable economic growth in the past five years through 2007, averaging about 6.3% annually. However, it has been facing multiple problems since early 2008, including the buildup of inflationary pressure in the first half of 2008; acute shortage of foreign exchange; difficulty in raising external funding; and intensification of the conflict in northern Sri Lanka. Growth was expected to decline as a result of the current crisis.

Channels of transmission

The current crisis has affected the Sri Lankan economy through the following channels and compounded its problems:

- **Decline in trade**: Exports of textiles, tea, agricultural products such as rubber and coconut, have been hit badly.
- **Decline in remittances**: Sri Lanka is highly dependent on remittances which account for around 7.8% of its GDP (as against 2.3% for India and 9.7% for Bangladesh). This is putting severe pressure on the current account.
- **Reduction in tourist inflows**: Tourism receipts from 1.5% of Sri Lanka's GDP as compared to 0.1% for Bangladesh and 1.1% for India as of 2006.
- **External borrowing** was becoming increasingly difficult: Sri Lanka's external borrowing to GDP ratio was very high (around 38%). Reversal in capital flows, risk aversion in external markets, depreciation of the rupee, and the downgrading of Sri Lanka's foreign currency risk from B+ to B was making it very difficult for the Government to meet its foreign currency requirements. Total official reserves have declined from US$3.5 billion in July 2008 to US$2.0 billion in November 2008,

amounting to just over 1.5 months of imports.

Way forward: Short-term Measures

As noted in the background paper, and affirmed by the discussants, the following measures have been adopted by the Government and improved results are showing:

- Easing of monetary policy. Repo and reverse repo rates have been lowered – for the first time since Oct. 2003. Other stimulus measures included lowering of fuel prices, export incentives, and exemptions for the tea industry. There was scope for further relaxation of policy rates.
- The Government was also taking measures to attract higher remittances – a Fund will be maintained for Diasporas' investments in T-bills and T-bonds. Investors would have the option to invest and withdraw in any currency. They have also been assured of competitive rates. The success of using the Diaspora bonds to finance external debt will only be known in the coming months. If the reaction is positive, this could become a useful route of mobilizing funds in the future.
- The IMF's Article IV Assessment reported that the real effective exchange rate of the Lankan rupee was overvalued and contributed to external instability. It has called for greater flexibility in exchange rate management.
- The Sri Lankan capital market, although modest in size, was viewed as an attractive frontier market by foreign investors, generating good returns averaging 25% year on year.

Way forward: Long-term Measures

The long-term measures to strengthen the economy included the following:

- Diversifying its economic base and export basket.
- Build up foreign exchange reserves – improve management of reserves.
- Fiscal consolidation
- Development and deepening of the capital market through education and reform measures – amendment of listing rules of the Colombo Stock Exchange, capacity building in supervision and development of markets.
- Regulatory changes to facilitate greater private sector investment and lower overall transactions costs of doing business.
- Infrastructure development.
- Regional cooperation to foster aggregate demand.
- Develop cross-border transport infrastructure to support a region-wide supply chain.

Concluding Remarks by the Chair:

- Given the close ties between Sri Lanka and Bangladesh, there should be greater cooperation between the two countries to exchange good practices and to establish economic links.
- However, there was a sense that the Sri Lankan authorities were more optimistic than others with regards to the risks they were facing.
- On exchange rates, given that Sri Lanka has a twin deficit problem, a flexible exchange rate regime was advisable.
- Reserves build-up should be complemented by an IMF program. This might well be the “magic wand” to build confidence.
- Regional cooperation should be pursued.

Session VII: Impact and Actions to be Taken: Bhutan and Maldives

Chair: ***Kunio Senga***, *Director General, South Asia Department, ADB*

Bhutan:

Discussants:

Daw Tenzin, *Managing Director, Royal Monetary Authority of Bhutan*
Nima Wangi, *Director General, Ministry of Finance, Bhutan*
Juzhong Zhuang, *Director, Economic Analysis and Operation Division, ADB*

Bhutan: Summary of Discussions:

Although Bhutan and the Maldives are two of the smaller economies in South Asia, their smaller size by no means implies that the impact of the crisis is less or that these economies face an easier adjustment process.

Overall Impact of the Crisis

- Bhutan is a land-locked country located in the Himalayan Mountains with close proximity to India. The economy is driven by hydropower production, 90% of which is exported to India. It has 5,000 megawatts of potential hydropower or development. The Bhutanese economy is closely linked to the Indian economy through trade and a currency peg (the Ngultrum and the Rupee trade on par).
- Some effects of the slowdown on Bhutan were a fall in demand for the steel industry and a setback in tourism. The financial sector was, however, relatively stable and isolated from the global financial crisis, and the exchange rate peg to Indian rupee was stable with international reserves providing cover for 13 months of merchandise imports.
- Bhutan's macroeconomic indicators remained strong with a low budget deficit and a surplus on the balance of payments current account. Since the economy was less affected by the global financial and economic crisis, not much policy response had been necessary.
- But as a long-term measure, Bhutan needs to diversify its economic base, which is currently heavily dependent on hydropower.
  Although Bhutan is financially not globalized, it is an aid- and import-dependent economy. Hence it was affected by the second round impact when commodity prices shot up in 2008.
- Bhutan displayed comfortable macroeconomic indicators, with GDP growing at 7%; inflation though rising was under control and its current account was in surplus. The fiscal deficit was at 2.5 % of GDP.
- Official reserves amounted to 10 months of imports. The build-up of reserves was not export-based but primarily attributed to international aid,

which therefore has to be prudently managed.

- The banking sector is highly regulated, there being only two commercial banks in Bhutan, but 2 new foreign bank licenses have recently been issued. Credit exposure to the construction and manufacturing sector and the resultant mismatch arising from borrowing short and lending long has become a source of concern.
- Bhutan's capital market is not developed and will need technical assistance from the ADB to develop its stock exchange while capacity building support could come from Nepal, Bangladesh and India.
- Fiscal discipline is not too satisfactory and there is need for better coordination between fiscal and monetary policies.
- In contrast to other countries in South Asia, Bhutan has no remittances inflow as 90% of its workers in the construction industry come from India.

Prospects in the Next Two Years

- The impact of global warming will affect its hydropower potential, making production dependent on rainfall than on snow.
- Some new manufacturing projects will be started. Development of hydropower jointly with India will be a win-win for both countries.
- Tourism revenue has potential to grow.
- The long-term challenges lie in diversifying the market and the overall economy.
- Being a latecomer, Bhutan has the advantage of being able to leapfrog technology.

Maldives

Discussants:

> ***Ali Hashim***, *Minister, Ministry of Finance and Treasury, Maldives*
> ***Abdul Ghafoor***, *Senior Executive Director of Financial Sector Division, Maldives Monetary Authority*
> ***Bruno Carrasco***, *Director, South Asia Country Coordination and Regional Cooperation, ADB*

Maldives: Summary of Discussions:

Overall Impact of the Crisis

The Maldives is a small island economy which is highly dependent on external demand for its trade and tourism services. As such, it is more vulnerable to the external shocks generated by the global financial crisis.

- **For trade,** its exports of fish and fish-related products may moderate;
- **For services**, tourist arrivals, in particular from Europe, have been

declining since the second half of 2008 although for 2008 as a whole, tourist arrivals were higher than in 2007. This has in turn affected the construction sector as new holiday resorts were put on hold.

The Maldives economy was strong until its devastation by the tsunami of 2004. Since then, the current account deficit grew bigger, due to the higher import bill and excessive public spending on civil service wages, and has resulted in a shortage of US dollars in the local market. The decline in foreign exchange reserves was exerting pressure on Maldives' fixed currency peg with the US dollar.

Short to Medium-term Measures

- Maldives needs urgent remedial measures to correct long neglected structural issues, which amongst others, were manifesting themselves through the progressively rising fiscal deficit (2008:13.6% of GDP) and current account deficit (2008: 51.9% of GDP). The limited fiscal space has restricted the Government's ability to take policy measures to mitigate the impact of the global financial and economic crisis. Removing subsidies and rationalizing expenditures are essential to arrest the deteriorating fiscal and balance of payments situation.
- There should be a strategic plan to attract tourists to the Maldives, including diversifying its markets out of Europe to tap the Indian and Chinese markets as well as the middle-income tourists.
- The policy of the newly formed government to privatize state-owned enterprises over 3 years may not be realistic. A 5-year time frame would facilitate privatization in 3 steps – first is to enter into joint ventures between public and private sectors; second to offer to institutional investors and third, to offer to investment by the general public.

Session VIII. Summary Of Country Discussions

Chair: ***Kunio Senga,*** *Director General, South Asia Department, ADB*

Discussants:

> ***Ashok Sharma****, Director, South Asia Financial Sector, Public Management and Trade, ADB*
> ***Bruno Carrasco****, Director, South Asia Country Coordination and Regional Cooperation, ADB*

The key messages coming out of the country discussions are summarized below.

INDIA

Message 1: Changing nature of the external shock required commensurate change in policy
Several leading indicators of GDP growth - export performance, automobile sales, credit off-take, and advance tax collections - have weakened since October 2008 and have resulted in slowing of economic growth. For most of 2008, in the face of high oil and commodity prices and rising inflation, the Reserve Bank of India (RBI) focused its efforts on containing inflation by progressively raising interest rates. By 3Q 2008, it became clear that India was being impacted by the economic slowdown which had started to take hold in the US by end-2007. As a result, the RBI switched course to support and sustain domestic demand by progressively lowering interest rates.

Message 2: The Indian economy will be impacted by the crisis, but the extent of damage is likely to be limited

There are four main channels of impact: Financial; Trade; Remittances and FDI. The impact of these channels varied,,thus suggesting that the Indian economy would be able to sustain the crisis. Although capital outflows have been large, thereby affecting market liquidity, India's relatively low export/GDP ratio means that trade effect would be limited—even though export of services is likely to be slower, as demand from Western economies weakens. As of now, remittances are holding steady. But those originating from the Middle East are susceptible to a decline as mega projects in the Gulf countries are either being abandoned or work stopped given the softening of oil prices.

Message 3: The monetary and fiscal response has been well sequenced and mutually reinforcing

Monetary response in the form of lowering of interest rates by RBI and some selected easing of equity market rules, followed by two fiscal stimuli packages will tend to limit the effects of the global slowdown. The Indian financial sector had little to no exposure to toxic assets, is well capitalized, and the reduction in interest rates and cash reserve ratios should unlock liquidity. In addition, RBI has established the *Liquidity Adjustment Facility* for banks for lending to non-banking financial companies, housing finance companies and mutual funds.

Conclusion

In summary, while the Indian economy has been impacted by the global crisis, the combination of timely monetary and fiscal responses, coupled with underlying soundness of the financial system will see India through the crisis. On the downside, the consolidated fiscal deficit is likely to increase and some export-oriented industries are likely to be adversely affected. The healthy domestic savings rate and large domestic market would act as a buffer against the softer international demand. Policy makers would need to develop measures both for the short-run and medium to long term. Ultimately, a sound macroeconomic framework is the best tool to minimize the adverse impacts of external shocks. Thus medium term policies that would reduce the budget deficit, improve the investment climate for PPP modalities, strengthen corporate governance, and reliance on RCI would help to not only overcome the crisis, but further strengthen the underlying policy framework.

PAKISTAN

Message 1: Weak Macroeconomic Framework resulted in Pakistan approaching IMF for Assistance

As a result of a deterioration in its macroeconomic indicators from mid-2007 onwards, Pakistan had to seek IMF's assistance under a Standby Arrangement (SBA). Political uncertainty, faltering growth rate, a large budget deficit, widening balance of payments current account deficit, rising inflation and rapidly depleting foreign exchange reserves meant that Pakistan had to seek external assistance in order to improve macroeconomic indicators and resume non-inflationary growth. When the IMF facility was approved in November 2008, the impact of the global economic crisis was just unfolding. In short, Pakistan approached IMF not as a consequence of global economic crisis, but due to the effects of rapidly rising international prices of oil and food commodity, and the delays in policy adjustments due to political uncertainty. The rules-based SBA had facilitated Pakistan in meeting time-bound targets for lowering imbalances and establishing the framework for sustained growth.

Message 2: Given the unfolding global economic crisis, should Pakistan change its SBA with the IMF?

The SBA was designed to correct the imbalances mentioned above. It is therefore desirable for Pakistan to complete the process initiated with IMF's assistance as it would then have a stronger and sustainable framework to cope with the adverse impacts of external shocks such as the global economic and financial crisis. Thus, staying the course is a better option.

Message 3: Does Pakistan have the resources to implement a stimulus package?

Presently, Pakistan does not have the fiscal space to introduce a fiscal stimulus package. The only other option is to create space through monetary policy. However, given that net foreign assets have already been drawn down, the only option is to increase domestic liquidity through money supply. However, this move would impede achieving the objectives of SBA, one of which relates to bringing the rate of inflation down from the all time high of 25%. Thus under the current macroeconomic circumstances, the only way for Pakistan to inject a fiscal stimulus, is through external assistance from multilateral IFIs which would create the counterpart domestic liquidity.

Message 4: Through what channels is Pakistan being adversely affected by the crisis? And is there a social safety net program in place?

These include trade (lower exports of textiles and cement as international demand softens), FDI (Pakistan capital markets have seen 63% flight of capital within a few months), and remittances (bulk of these originate from the Gulf where construction projects have either been abandoned or put on hold). One of the few areas where Pakistan has the flexibility under the SBA to increase expenditures is on targeted social safety nets such as the Benazir Income Support Program.

Conclusion: The Way Forward

Pakistan's banking system has little exposure to toxic assets and NPLs are low. However, it needs to strengthen its equity market and explore ways and means to engage the private sector in meeting large investment gaps in infrastructure (power, gas and physical infrastructure). But first, it has to complete the SBA with the IMF so as to provide Pakistan with a much more stable macroeconomic framework and the necessary fiscal space to increase capital expenditures and resume a non-inflationary and sustainable growth path, accompanied by private sector partnership in its economic development programs. Pakistan must also continue to actively stay engaged in its RCI initiatives. Until the successful conclusion of SBA, Pakistan's external credit ratings require a very high-risk premium to raise capital from international markets. It can, however, consider requesting greater multilateral assistance to ease the costs of adjustment.

BANGLADESH

Message 1: The economy showed resilience so far, but there are risks

The impact of the global economic and financial crisis has so far been insignificant in Bangladesh. Fiscal and external balances were maintained. The economy is projected to grow at 5.5-6.0% in FY2009. Since little impact has been observed, there were few policy changes. However, recession in development countries and lower oil price may affect the economy as Bangladesh depends on the export of garments to the US and Europe, and remittances from the Gulf region. Some signs of slowdown of export and remittances have been reported.

Message 2: Need to be prepared for policy measures

Therefore, the country should be prepared to take necessary actions to mitigate the slowdown when it happens. The government has established a monitoring cell to watch the situation, and take necessary policy measures when needed. Fiscal policy would be an option since the monetary policy is already accommodative and credit has been sufficiently provided.

Message 3: Take long-term measures to reduce vulnerability

In the medium term, Bangladesh should take several measures to reduce its vulnerability to external shocks, which could include stabilizing export and remittance inflow, diversifying its export base, and upgrading migrant workers' skills to enhance their employment opportunities. Reform of the financial sector to improve its efficiency would help to promote infrastructure investment. Finally, fiscal space should be created by enhancing the revenue base.

NEPAL

Message 1: Dependence on India as its single largest trading partner would be a cause for concern

Nepal’s economic performance has been buffeted in recent years by the strong growth in India. As India enters into a period of slowdown, Nepal’s export oriented sectors would be affected. This together with the decline in tourism and remittances would trigger unemployment and social unrest. Develop a strategy to increase trade outside India.

Message 2: Public spending on infrastructure and raising productivity

While Nepal has the fiscal space, coordinated efforts should be undertaken by the government to spend on infrastructure to create jobs to absorb returning migrant workers. It is important for Nepal to continue with the broader objective of macroeconomic management while addressing structural issues of raising productivity. Resolving power shortages in the country is key to the productivity issue.

Message 3: Clarity of monetary policy direction to contain inflation

Inflation is a potentially major threat and requires effective monetary management.

SRI LANKA

Message 1: Crisis affected Sri Lanka through external borrowing and will weaken external demand

Sri Lanka's external borrowing to GDP ratio was very high (around 38%). Reversal in capital flows, unfriendly external market conditions, depreciation of the rupee, and the downgrading of Sri Lanka's foreign currency risk (from B+ to B) is making it very difficult for the Government to meet its foreign currency requirements. Similar to Bangladesh, Sri Lanka also depends on exports of garments and remittances. Tourist inflow is another source of foreign earnings. The second round effect of the crisis would be transmitted through these channels.

Message: 2: Monetary and fiscal policies are taken

The Government has relaxed monetary policy and toll fiscal stimulus measures, including the lowering of fuel prices, export incentives, exemptions for the tea industry, and support for finance and leasing companies. Sri Lanka is also taking measures to attract higher remittances. A fund will be maintained for diasporas' investments in T-bills and T-bonds by assuring them of competitive rates.

Message 3: Improve economic fundamentals to stabilize the economy

For immediate action, the exchange rate should be more flexible to adjust and stabilize the balance of payments. The IMF in its assessment reported that the real effective exchange rate of Sri Lankan rupee is overvalued. The central government’s intervention to maintain the exchange rate has decreased the Gross Official Reserves to 1,753.4 million or 1.5 months of imports as of end December 2008.

For the medium term, the government should focus on fiscal consolidation, diversifying its economic base and export basket and infrastructure development. Other reform measures should include changing regulations to facilitate greater private sector investment and lowering the overall transactions costs of doing business. Regional cooperation to foster aggregate demand, and investment in developing cross-border transport infrastructure to support a region-wide supply chain would also be beneficial.

BHUTAN and THE MALDIVES

Message 1: Less diversified economies tend to develop greater external dependence

Economies which are less diversified to begin with will face a more severe adjustment process. As such, the economies of Bhutan and the Maldives are largely dependent on the energy and tourism sectors, respectively and while the countries have effectively exploited their natural endowments to successfully develop these sectors, they do face an external dependence on India – as a market for Bhutan's export of electricity – and Europe – as a tourism market for the Maldives. A deep and prolonged crisis affecting India and Europe would have repercussions on economic activity in Bhutan and more significantly on the Maldives.

Message 2: Efforts to diversify these economies require mobilizing increasing foreign investment

Both countries are making significant strides to diversify their economies. The Government of the Maldives, for example, has announced the pursuit of a privatization agenda that will very much seek to attract key strategic investors. It will also seek to reduce the size of government and through a decentralization process, bring services closer to the people. Bhutan is also focusing on improving services to its people including an important focus on rural electrification. This process of improving services will require attracting FDI for the improvement of basic infrastructure. A deep and prolonged global recession will likely add further pressure on mobilizing investments and may slow down the speed at which the countries are able to implement their national development strategies.

Message 3: Upfront measures to strengthen economic management are critical

A lesson learned from this crisis is that those economies with weak economic fundamentals, including large fiscal and current account deficits, have become more vulnerable. While Bhutan has maintained strong fundamentals, in the case of the Maldives these fundamentals weakened under the previous administration, particularly after the tsunami. However, the Government of the Maldives is undertaking reforms to critically reduce spending and introduce a taxation system to ensure a sound and predictable revenue base under its forthcoming budget. These measures will go a long way to bring to the forefront macroeconomic stability considerations and with it the confidence and trust that the business community in and outside the Maldives is looking for to re-engage and reinvest in the country. However, the corrective measures are urgent and if tourism deteriorates further, the reform measures will have to be accelerated.

Session XI: Need for Long Term Actions – National, Regional Coordination and the Role of Multilaterals

Chair: ***Rajat M. Nag***, *Managing Director General, ADB*

Discussants:

Bangladesh: ***Faruq Ahmad Siddiqi***, *Chairman, Securities Exchange Commission, Bangladesh*
Bhutan: ***Nima Wangdi***, *Director General, Ministry of Finance, Bhutan*
India: ***Arvind Vermani***, *Chief Economic Advisor, Government of India*
Maldives: ***Ali Hashim***, *Minister, Ministry of Finance and Treasury, Maldives*
Nepal: ***Rameshore Prasad Khanal***, *Secretary, Ministry of Finance, Nepal*
Pakistan: ***Syed Salim Raza***, *Governor, State Bank of Pakistan*
Sri Lanka: ***Ajith Nivard Cabraal***, *Governor, Central Bank of Sri Lanka*
Private Sector: Surjit Bhalla, *Chairman, Oxus Research and Investments, India*
ADB: **Madhur Srinivasa**, *Director, Office of Regional Economic Integration, ADB*

The roundtable discussions focused broadly on three issues:

- Does South Asia need a sound monitoring system?
- Can South Asia draw lessons from the ASEAN+3 Chiang Mai Initiative?
- What would be the medium term and long term institutional mechanisms?

Sri Lanka

There is urgent need for a global institution to truly support the cause of the developing countries, instead of mere pronouncements and rhetoric so far. This calls for a reform of the IMF in particular to make it easier for member countries to access its facilities.

There should be more use of communication in South Asian countries to boost confidence and to contain the contagion effects.

Bangladesh

Policy responses to the challenges of the global crisis can be categorized into three groups:

Immediate policies:
- Ensure effective monitoring of key commodity markets;
- Early implementation of development programs; Export incentives for power generation industry;
- Boost public-private partnerships; Diversify incomes base;
- Ensure food security;
- Export credit schemes for micro-economic sectors.

Short and Medium term policies:
- Minimize losses and subsidies to SOEs;
- Financial market stabilization;
- Improve quality of education;
- Establish skills training programs.

Long-term policies:
- Accelerate economic growth;
- Strengthen government institutional framework;
- Regional cooperation in exports, remittances and foreign direct investment.

Bhutan

- An ADB regional assistance program would be welcomed by countries like Bhutan to develop their statistical systems for monitoring the economic situation. Bhutan and the Maldives could share an ADB representative office for this purpose.

India

- India's export-led growth will be threatened for many years to come because of the slowdown in world trade.
- India should focus on developing its capital market to mobilize domestic savings.
- Short-term policies should be in the form of stimulus programs, like injecting cash payments for the poor. Long-term policies should be aimed at building infrastructure and raising productivity.

Maldives

- Agree with Bhutan's proposal for an improvement in the monitoring system. Maldives would gain from similar support.

Nepal

- Nepal needs assistance from the multilateral institutions in areas of infrastructure like telecommunications to improve efficiency in the economy.

- There is potential for South Asian regional cooperation in trade, energy, water, tourism and collective issues, such as climatic change.

Pakistan

- As a region, South Asia could cooperate in the development of regional debt markets (supported by a regional rating agency), trade financing and warehousing.
- South Asia could share in the technology of developing power and energy infrastructure.
- In the food industry, Pakistan is the largest meat producing country in the region but lacks the distribution chain. Weakness in distribution and commerce is the main setback for Pakistan's domestic consumption market.

Other Views

Surjit Bhalla views the "Middle Class" as the world's greatest "institution" for reform and progress. Strengthening the middle class to be an impetus of growth will help the world out of the current crisis.

Srinivasan Madhur:

- Asia will slowly and steadily become too big an entity to just rely on exports for generating growth. It will have to generate growth from within and fuel domestic demand to become the engine of growth.
- There is no doubt that Asia needs to integrate regionally. If South Asia is to be part of this integration process, India has to play a big role because of its size. As of today, India is the only South Asian country that is a member of the East Asian Summit.
- In implementing fiscal stimulus packages, there are three principles to observe - measures have to be timely, targeted and temporary. Coordination of implementation is important.

Concluding Remarks by the Chair

1. It is clear from the roundtable discussions that greater regional cooperation and integration is needed. The Forum has met its objective of sharing cross-country experiences on the impacts of the crisis and on the ongoing and planned measures to offset the adverse effects of the crisis on their respective markets and economies.

2. In going forward, the challenge for all is to convert this crisis into an opportunity to strengthen our policies and institutional framework not only in addressing the present situation, but be better prepared in case of a repeat of such a crisis in the future.

3. Whilst there are no two views that our response ought to be country-specific, there are some common cross-country objectives towards which we must collectively work for. These common objectives include:
   - Preserving the hard-won gains against poverty
   - Strengthening social safety net programs by sharpening their focus
   - Resisting temptation to limit international trade and commerce
   - Strengthening the financial sector regulatory framework, revisiting prudential guidelines and strengthening the capital adequacy of financial institutions
   - Deepening and strengthening corporate governance including compliance with stock market listing requirements, accounting and auditing procedures, enhancing transparency,
   - Invest in infrastructure for sustaining growth, and
   - Strengthening regional cooperation initiatives
4. Ultimately, a global crisis requires a global solution. Aside from the immediate short-term actions to stabilize finance, a longer-term plan for reforming the regulatory and institutional framework for the world's financial systems is needed. In this respect, there have been lively discussions in recent global forums—including the G20 Finance Ministers and Central Bank Governors meeting and the International Monetary and Financial Committee.
5. With its growing influence on the global economy, Asia must have a seat at any table seeking a solution. This is particularly true given the amount of savings Asia has parked in the assets of advanced economies, particularly in the US Treasury. Asia, in other words, must now take greater responsibility as a cooperative and responsible partner to help address global challenges.
6. In this context, the views of South Asian countries are needed on the appropriateness of some proposals where ADB could lend its experience and support:

- **On maintaining regional domestic and financial stability:**
  Would South Asian countries want to consider a facility similar to the **Chiang Mai Initiative (CMI) of** ASEAN+3, which offers emergency liquidity injections to countries experiencing urgent liquidity shortage?
- **On building sound monitoring systems:**

The crisis has exposed the weakness in the monitoring mechanisms of even the most developed economies. ADB supports the need for strengthening the monitoring of the financial system and key economic sectors; developing supporting data base and statistical tools; and building the capacity for undertaking these initiatives. The need for this may vary across countries. It is possible, that countries with advanced systems could support others. A strengthened monitoring system is the foundation for regional economic cooperation.

- **On improving connectivity:**
  Improving connectivity is essential to enabling countries in the region to access broader markets and consequently improve economic performance. Connectivity also allows South Asia to benefit from the economic integration of South-East Asia, which itself is a crucial link to other parts of Asia and the world. Hence there is potential for South Asia not only to be well integrated internally, i.e., with its member constituents, but also with other sub-regions, so as to build a more vibrant Asian Economic Community. Physical connectivity, of course, requires extensive infrastructure development to facilitate the movement of goods, services, people and information. In this context, sharing PPP experiences and PPP project development with active private sector participation are considered important.

7. To continue this dialogue, ADB proposes to hold the next Forum in three or four months' time to update ourselves on the unfolding impacts of the crisis and the needed responses as well as the results of the stimulus packages already undertaken; and to develop background materials for facilitating regional and sub-regional experiences and the proposals. The ADB also agreed to the proposal to expand participation at the Second Forum to include policy makers from East Asia (especially ASEAN+3) and Central Asia, for the cross sharing of experiences.

Closing Session

Chair: ***Xiaoyu Zhao****, Vice President (Operations 1), ADB*

Closing Address by Hon. Arun Shourie, Member, Parliament of India; Former Minister of Telecommunications, Commerce and Privatization

In his address entitled " **Responding to the Economic Meltdown - Some Lessons for South Asia"**, Mr Arun Shourie made the following observations:

Several features about the current economic crisis stand out:

- The first was the sheer scale of what preceded it, and the magnitude of what has happened in its wake. On the eve of the outbreak of the crisis, the nominal value of financial derivatives and exchange traded derivatives had soared to *fourteen times* the world's GDP.
- The second feature is the pace of wealth destruction in this round: there has been another period of four to five months in which almost *fifty trillion dollars* worth of wealth has been wiped out.
- Third, unlike the Southeast Asian crisis which was on the periphery of the world economic system, this one has struck at within the heart of the world's financial system.
- Fourth, the world is much more integrated than what has been thought to be. Economies have been inter-linked by confidence, and this has been shattered. Till confidence is restored, things will not begin to turn around. And notice that as yet, the 4 trillion dollars notwithstanding, nothing that the governments of the US, Europe or Japan have done has shored up confidence.

In spite of the scale of the breakdown and the ineffectiveness of the policy measures taken so far to shore up confidence, many governments, including the Government of India, are underestimating the impact of the crisis on their economies.

- *The first lesson is for governments not to remain in denial.*

- *The second lesson is not to allow governments to use stimulus package and fiscal deficits as a cover-up for poor performances in the past*. A return to fiscal discipline is necessary precisely for meeting the crisis.

Nature of the Stimulus Packages:

They must be location-specific, industry-specific and firm-specific relief.

An aspect of the crisis that needs to be addressed are stimulus packages. The crisis is no longer a generalized one - it is sector-specific, location-specific and firm specific. To be of help the relief must be in the locality and in the industry that has been hit. For instance, a failure of even one firm will not just be a problem for that firm, it will be yet another blow to confidence in general. Hence, governments should be planning not just general packages but location-specific, industry-specific and firm-specific relief.

The financing needs of small and medium enterprises must not be ignored.

With sources of external commercial borrowing having dried up, Indian corporates, for instance, will be turning to Indian banks and the Indian market. The small and medium establishments, already hit by the sudden and extreme risk-aversion that has seized our banks like banks elsewhere, will now be marginalized. Yet, in India, SMEs account for 40 per cent of manufacturing output, that is about 17 per cent of the country's GDP. It accounts for close to 44 per cent of exports. Most important, it employs close to 30 million people. Closures and lay-offs in this sector will be diffused. But they will be of an order that, if unattended, can trigger social unrest.

Identify vulnerable units in sectors perceived as strong and prepare contingency plans.

For the same set of reasons, governments should be alert to early signs of stress even in sectors that are conventionally regarded as strong. In India, for instance, it is generally assumed that its banking sector is safe as it has been conservative. It has made substantial progress in bringing down non-performing loans to just about 2 per cent of its outstanding portfolio. But recent studies by Morgan Stanley and McKinsey – remind us of other facets: about 40 per cent of corporate India's asset base has a return on incremental capital that is lower than the cost of capital; and Indian banks have lent US$100 billion to these vulnerable firms – loans that account for a fifth of total bank loans. In a word, take no sector for granted. Identify the vulnerable units in each sector, and prepare contingency plans for them – remembering that a collapse of any constituent of any sector will impair confidence further.

In such an environment, the real stimuli are the ones that strengthen the viability, sustainability, and competitiveness of the economy for the long run. A good example of this kind is the announcement in the US that it will be deploying a good portion of its stimulus plan towards creating a green infrastructure. Outlays to create alternate energy which liberate economies like those of South Asia from their current dependence on imported oil supplies; expenditures to multiply and enlarge manifold the current facilities available for higher and technical education, facilities which would overcome the extreme shortage of technical personnel in these countries would be examples of the same kind.

An excellent initiative, one that we should emulate, is available from

Singapore. The Government has launched a plan under which a person losing his job can enroll in an institution for acquiring higher skills than the ones that are required for his existing job. He is paid a stipend for every day that he attends a class for five hours of class. When the current downturn is behind us, the person will be able to seek a job which is better paying and which demands more of him than the job that he has just lost.

Strengthening Implementation Capacity.

The crucial variable here is the ability of the country to execute these projects expeditiously. This is why China is way ahead of, say, the typical South Asian country. To begin with, it has $ 2 trillion of reserves. With these it can finance massive infrastructure projects – an option that is not available to a country like India which, through the Government's profligacy of the past three years, has robbed itself of fiscal headroom. Equally important, China has large supplies of engineers and skilled personnel – because of the extensive programs that it had implemented earlier for both, training engineers as well as for upgrading vocational skills. With those two trillion dollars it can also, as it is doing, acquire mineral and other resources in other parts of the world, the resources that it will need for its long-term growth. Most important, China has a shelf of projects that it can reportedly start implementing forthwith. Several of them had been prepared earlier but were kept in abeyance, in a sense, as it was felt that the economy was overheating. Now they can be implemented without any delay. And that is possible because China has overcome the customary obstacles which hold up the execution of projects in countries such as ours. It has acquired an unmatched capacity to implement projects expeditiously.

In the case of India, the current crisis presents it with an opportunity to make every effort to acquire the ability and resources to improve the capacity to implement projects more expeditiously in the future. Some straightforward measures could be in the form of significant rewards for firms and local and provincial governments that expedite the implementation of projects and tax rebates for companies which, instead of laying off workers, retain them and have them acquire better skills.

A role for the ADB

An institution like the Asian Development Bank can play a vital role improving the capacity of countries in the region to implement domestic projects, as well as including cross-country regional projects. There are a large number of such projects which can be implemented, such as setting up power projects in Nepal from which power is sold mostly to India; setting up projects to exploit the natural gas resources of Bangladesh from which a large proportion of gas would be sold to India. These projects have not got off the ground for decades because undertaking them has become a political issue within Nepal and Bangladesh.

This is where the Asian Development Bank, with the trust which countries in the region have of its fairness, s objectivity and expertise, can play a vital role. It should, for instance, draw up the terms and conditions which would be best for Nepal and would be fair to India for implementing power projects in that country. This is the role which would be more appropriate than to expend time and effort in setting up yet new institutions.

Reforms and Governance

One of President Obama's advisers has a good maxim: "No crisis should be allowed to go waste". The new circumstance should, therefore, be used to effect improvements that are necessary in the light of the crisis as it has unfolded, and at the same time to institute those reforms which will enable our countries to adopt policies and implement projects more expeditiously – policies and projects which, as we noted above, will strengthen the viability, competitiveness and sustainability of our societies for the future.

But all this is contingent on our having clear-headed, competent, purposeful, strong governments. This is the real deficit, the real crisis in our societies – apart from the advance that has been registered in Sri Lanka of overcoming the terrorist threat, and apart from the steady hands that guide Bhutan, governments in South Asia are losing grip as well as legitimacy. No stimulus package, no slew of economic reforms can survive the wreckage of governance.

Closing Remarks by the Chair

To bring the two days of constructive and useful deliberations to a close, the Chair found it useful to do a quick recap of the key points that have emerged.

- This is a truly international crisis, unprecedented in scale and reach. This crisis has global, regional, and country-level dimensions.
- There is a need for a new global financial architecture which would be democratic, accountable, and endowed with adequate powers is recognized by all.
- The scale of the crisis and the extent of its impact could be meaningfully assessed or rather guessed by coming together and candidly discussing the case of each country, as we did.
- While the stimulus measures adopted by countries are context specific, collective measures through regional coordination will result in a win-win situation.

In response to the crisis, ADB has stepped up operations by several billion dollars from the originally planned $12 billion in 2009 in spite of resource constraints, and endeavors to assist its developing member countries affected by the crisis by employing a combination of measures including targeted lending, greater use of guarantees, and enhancing co-financing.

However, for it to deliver our mission of poverty reduction in Asia more effectively, ADB needs an immediate and substantial capital increase, and we are asking shareholders to reach an agreement by the upcoming Annual Meeting.

Going Forward.

The two-day discussions enhanced everyone's understanding of the various ramifications of this unprecedented crisis that we face. Since joint learning and coordinated action is the best way to handle a crisis, ADB will continue to engage with experts and national decision makers to:

- Update ourselves with the unfolding impacts of the crisis and the needed responses as well as the result of the stimulus package already undertaken;
- Expand participation at the Second Forum to include policy makers from East Asia (especially ASEAN+3) and Central Asia, for the cross sharing of experiences; and
- Develop background materials for facilitating regional and sub-regional experiences especially on the proposals.

The proposed changing scope of the Forum will be studied to assess where ADB support would be most effective.

The Chair expressed his gratitude to all the experts and participants for sharing their views and invaluable insights with the ADB. The ADB will not only document what it has learnt, but will also continue the process of sharing and learning from each other's experience, recognizing that the crisis is most likely to be with us for the near-term.

The Chair also thanked the South Asia Department of the ADB for organizing this meeting. The group was expected to meet again after three to four months.

June 2009