

NAVIGATING THE CROSS-CURRENTS OF GLOBALIZATION

by

H.E. Ginandjar Kartasasmita

Coordinating Minister for Economic Affairs, Finance, and Industry

The theme put these questions before us. What are the nature of interactions between economies and different trends? The trends are rapidly advancing technology, falling trade barriers, increased financial mobility? Can governments control where economic forces are taking them?

Those are questions that have consumed thousands of volumes and hundreds of seminars. But they are not only challenges that test the intellectual power of our academia, they are also very concrete subjects that public policy makers are being confronted with in real life.

Let me outline some thoughts on the basis of our own experience in Indonesia. I will identify four issues: (i) market volatility; (ii) protection from external forces; (iii) benefiting from globalization; (iv) priorities for the international financial system.

i. Market volatility

The first question is the disparity between the size of investable portfolio capital and individual emerging market countries' economies; their ability to absorb large flows of portfolio productively. How can the large amounts of capital directed to small economies be productively invested, i.e. in real production not speculative activity such as property construction or excess capacity in manufacturing?

The speed of the modern capital markets has reduced Governments' response times. There is a greater danger of sharp moves in financial markets and sudden increases in volatility. In this context I should like to note how the rupiah fell so sharply to 16,000 in January 1998 even though fundamentals had not changed by anything like as much.

The sudden devaluation of the rupiah resulted in inflation and the immediate technical bankruptcy of much of corporate Indonesia. In turn companies' sudden negative net worth resulted in an abrupt halt to investment and employment opportunities creating a self-perpetuating crisis of confidence and economic misery.

Third, Reliance on foreign markets or capital providers increases a country's vulnerability because of the natural tendency for capital to seek a 'safe haven' in times of crisis and because foreign investors or managers tend to be less informed about distant emerging markets, increasing their riskiness. In our case shares in dollar prices slumped to as little as 10% of their previous value.

Being specific, in the current crisis, some countries have imposed controls on the movement of capital. While other countries maintain open capital account system. We opted for the second path.

We feel there is a strong argument for permitting financial markets to operate freely while at the same time acting to prevent damaging and exaggerated moves. This presents a role for governments to slow markets down occasionally and to improve information flows to ensure that decisions are rational and not based on second-guessing others.

In addition, we have found, the hard way that the best way for countries to protect themselves from crisis is to run sound fiscal and monetary policies coupled with strong but sparing domestic regulation to ensure the health of the financial system.

ii. Benefiting from globalisation.

Globalisation should be welcomed, particularly by emerging market countries. It actually offers an opportunity to break down the historic advantages enjoyed by the 'rich' countries. For example, the abolition of capital controls in the rich countries means that they can now invest in emerging markets' economies.

In our case there is little doubt that Indonesia has benefited from its increasing integration in to the global economic scene. It is important to recall that when Indonesia began the process of transforming itself into a modern economic state, the traditional policy paradigm was based on the development of import substituting industrialization.

Our move toward a closer integration of the domestic economy with the world economy began about two decades back when we moved to lower trade restrictions and liberalize investment laws. The results were dramatic.

Modern sector employment increased rapidly and real wages rose. We made tremendous progress in reducing the number of citizens living below the poverty line and in raising per capita incomes.

The case for opening markets to foreign trade and foreign direct investment is compelling. Indonesia enjoyed higher rates of growth, higher rates of improvement in labor productivity, and higher gains in welfare once it decided to become more closely integrated with world markets. Although the current global financial crisis has eroded some of these gains, the crisis has by no means eliminated all the gains.

The current economic crisis has however had tremendous consequences for the Indonesian economy. The sharp increases in prices, accompanying the very sharp depreciation of the currency, have served to erode the purchasing power of a large number of people. Interest rates have declined but remain high by historical standards and few banks are as yet capable of lending to investors.

Not surprisingly these developments have raised questions in Indonesia and indeed globally about the value of further liberalization of trade in goods and services. The challenge is how to head off the potential backlash against globalization how to seek means of ensuring that we can continue to reap its benefits without exposing our economies to sudden sharp "reversals of fortune." Hence the question of how we can manage globalization and the risk of sudden crises.

iii. Priorities for the international financial system

This is an endeavor of our country, especially the emerging country can do it alone. It is very clear that the operations of the international financial community must be improved.

It is important to recall that the current financial crisis in East Asia, in Russia, and now in Brazil, has its origins not in mainly a failure of government economic policies but in excessive private debt exposure. Weak or badly managed economic policies may have exacerbated the crisis, but they did not cause it. Obviously the large private capital flows have created substantial benefits. But they come to us with a substantial risk. The problem that confronts us is to ensure that such private capital flows continue even as we establish controls that will reduce the risk.

Finally, I would like to propose three suggestions. The first two, directed toward a longer term, a structural reforms to establish better risk management and supervision to improve the financial system's capacity to weather large capital flows which show no signs of reducing.

First, there is a substantial and real need for better and more current information on private capital flows. Individual countries can do much more to collect such information. However, if individual countries impose reporting requirements on capital flows, they will be perceived, fairly or unfairly, as having taken the first step to the imposition of capital controls. This may have negative implications for both the volume and cost of such flows. If such data is collected through a multilateral agency on a fully global scale, the cost of such data collection efforts will be minimized. The Bank for International Settlements already provides information on private capital flows. But this effort needs to be expanded in order to provide a more completely picture

Second, not only do we need better data on such capital flows, we need to have a better understanding of the risks associated with such flows. The development of ever more esoteric financial instruments, including derivatives, makes it difficult to trace flows and often makes it impossible for governments and others to understand the true exposure that is created by such instruments. What is required here is not only more information on the volume of private capital flows, but on their structure and risk. Central banks can only monitor their exposure to foreign exchange risks if they have a true assessment of the types of instruments used to access capital, and of their associated risks.

Third, which is our short-term priority is the effort to prevent or cope with contagion. In this regard, during many sessions in the Forum many have referred to moral hazard. It has been said that it would be wrong to extend substantial help to countries in crisis because it would provide the wrong incentives to the markets. This is a good theory but it fails the test of pragmatism. The cost to the world of the current crisis, first in Asia, then in Russia and now in Brazil will far exceed the cost of a sufficient real money package. For example, the losses suffered by the US and European stock markets are a substantial amount. So that the idea of large-scale standby arrangements is a good one. These should be akin to a lender of last resort function which has also been discussed extensively during many meetings.