



**Conference on
Global Financial and Economic Crisis
Fiscal Policy Issues after the Crisis
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**Welcome Remarks
by
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Distinguished guests, ladies, and gentlemen. Good morning. Let me express my gratitude to all of you for taking time from your busy schedule to participate in this conference on **Fiscal Policy Issues after the Crisis**, which is being organized jointly by the ADB, the Ministry of Finance Policy Research Institute, the Hitotsubashi University Center for Intergenerational Studies, and the International Development Research Centre of Canada.

The conference will address the fiscal policy implications of the global financial and economic crisis for Asia. We will particularly focus on issues of fiscal sustainability and the trade-offs between fiscal consolidation and economic growth. This is a very timely topic, since, after the extraordinary measures that were adopted over the past 16 months to support financial stability and aggregate demand, there is a clear need to guide fiscal policy back to a stance that is sustainable from the standpoints of managing public debt while maintaining market confidence and economic growth.

Asian policy success

Even though the crisis did not originate in Asia, and Asian economies generally had strong economic and financial fundamentals going into the crisis, the region still was hit hard by the downturn in export demand, and, in some cases, by turbulence in foreign exchange and capital markets as a result of a sudden withdrawal of capital. Exports declined sharply, often by 30% to 40% year-over-year in many Asian economies, and even more in a few economies, although export levels have recovered substantially. Domestic demand, especially private capital investment, weakened in many economies as well, and almost all economies have shown a rapid widening of the output gap.

Asian policymakers have responded to this crisis with aggressive and appropriate measures to ease monetary and fiscal policy and to support domestic financial systems. The Asian Development Bank (ADB) estimates that the fiscal stimulus measures taken by China, Malaysia, Singapore, and Viet Nam exceeded five percentage points of GDP in size, while those of Hong Kong, India, Japan, Korea, the Philippines, Taipei, China, and Thailand amounted to between two and five

percentage points of GDP. The ADB itself contributed to these measures with disbursements of about \$2.5 billion in total of special loans to support fiscal spending to Bangladesh, Indonesia, Kazakhstan and the Philippines from its Countercyclical Support Fund (CSF), which was introduced last June. These policies have clearly worked, as Asian economies rebounded strongly, growing at an annual average pace of 10% for the period from April through September last year. This recovery was both earlier and far stronger than that seen in the US and Europe.

The fact that the Asian economies were able to take such substantial measures underscored the dramatic improvement that had taken place in macroeconomic management and fundamentals in these economies since the Asian financial crisis of 1997-1998. A number of regional central banks had achieved low inflation as a result of commitments to non-inflationary policy, while many governments had substantially reduced fiscal deficits and levels of public debt. These developments very much enhanced the fiscal and monetary policy “space” that the Asian economies enjoyed going into the crisis.

Need for adjustment

Now, however, the bill for these stimulus measures must be paid. Fiscal deficits have expanded and government debt levels have risen substantially. Financial commitments such as blanket guarantees of bank deposits have been made as well. To be sure, since the direct financial damage was much less than in the US and Europe and trend growth is higher, the fiscal imbalances in most of emerging Asia created as a result of the crisis have been considerably smaller than those of the developed economies. Nonetheless, there is much work to be done to normalize the fiscal policy stance and stabilize debt levels while maintaining a smooth transition to sustainable economic growth led by private demand. The recent fiscal developments in Greece and some other European nations should focus the minds of Asian policymakers on sustainability issues.

A number of questions need to be addressed. First, we must develop a framework to understand the factors that determine the degree of fiscal adjustment needed to achieve sustainable levels of public debt. For example, what is the maximum debt level consistent with keeping the risks of debt management under control? What factors affect the primary surpluses required to achieve both debt sustainability and economic growth? Recognizing the risk of future crises, what level of fiscal space needs to be obtained going forward? The answers to these questions need to be based not only on theory, but also from the experience of previous episodes of fiscal expansion during crises, both in developed and emerging economies. What were the problems encountered during the current and previous crises, and what solutions have been developed? What are the major risk factors for emerging markets in particular?

Second, we must consider fiscal consolidation in a dynamic perspective, that is, how rapidly fiscal adjustments can be implemented without endangering recession on the one hand, or damaging fiscal sustainability on the other. The longer-term structural context is important as well. For example, how can fiscal restructuring be balanced against long-term investment needs in areas such as infrastructure, or social protection programs? How do longer-term factors such as demographics constrain fiscal policy responses? In some countries such as China, structural measures to encourage household consumption need to be given a priority, particularly the strengthening of public social protection systems—including those for health, education, unemployment, and pensions—to reduce household needs for precautionary savings.

Third, we must examine the details of fiscal adjustments. What are the relative merits of tax increases versus expenditure reductions? What areas of tax increases and expenditure reductions are most promising? What strategies have been most effective in implementing such adjustments? Do we need certain fiscal rules or institutions to achieve fiscal adjustments?

Fourth, we must understand the appropriate roles of monetary and currency policy in facilitating the needed fiscal adjustments. For example, China's expansionary policies have relied primarily on rapid growth of fixed investment and bank lending. A rapid increase in fixed investment could lower the efficiency of projects and create excess capacity, without contributing to overall productivity. A rapid expansion of bank loans—which grew at a rate of more than 30 % last year—raises the risk of a sharp increase in nonperforming loans later on, as well as a rise in future inflation and possible asset price bubbles. Recent monetary tightening measures announced by the People's Bank of China show that the Chinese authorities are fully aware of these risks.

Finally, we must explore the role of global and regional cooperation to balance fiscal adjustments against longer-term growth needs. Clearly, information sharing on both successful and failed initiatives of fiscal consolidation would be useful. We may also wish to consider international spillover effects of a country's fiscal adjustment and the potential need for information exchange and, if necessary, concerted and coordinated action.

I believe that all of these important issues will be debated here at today's conference. Hopefully, these discussions can point toward key fiscal policy recommendations, which can be taken by Asian governments to achieve balanced and sustainable economic growth for all. I thank you for your kind attention.