

## Finance for Development: Latin America, East Asia, and Eastern Europe

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### Changing Views on Finance

The main question when setting out with this topic is, in a basic sense, why does East Asia have the strongest and deepest markets when compared to other regions? This is about comparing regions and comparing data and the kind of implications that this has on the future.

To start off with, we should look at the changing views on finance, in particular its relation to developing countries. Traditionally, finance had not been regarded as that important when compared to the “real” sector economy. The limited interest in finance was mainly on FDI.

However this view soon changed with financial liberalization and finance came to be seen as a vehicle for growth. As this liberalization process went on, state banks were no longer viewed as being efficient. They were then sold off, often to foreigners as their role as agents for development changed.

### Regional Comparisons

East Asia has the deepest markets whether measured in its entirety or just by each individual component. Latin America and Eastern Europe are very different in the way their components are made up. For Latin America, capital markets are important, while for Eastern Europe bank credit is more important.

### Liberalization Process

The liberalization process in East Asia and Latin America has been more gradual when compared to Eastern Europe. And although markets in East Asia have tended to be less liberalized, the difference is not so great when compared to Latin America. Eastern Europe has the most liberalized markets but this is the culmination of a rapid process that begun with the fall of the Berlin Wall.

### Changes in Bank Ownership

Bank ownership is rather an interesting area in East Asia. While the figures show that there has not been much change in the ownership from public to private, the data is affected by the 1997 financial crisis. Although a process of privatizing the banks took place, they were following the 1997 crisis renationalized again. Latin America in comparison has seen a more gradual shift from public to private ownership. Eastern Europe has shown a strong trend to move towards foreign ownership.

### Explanations for East Asian Strength

There are three ways in which we can try to understand why East Asia has been so strong. It is related to macroeconomic performance, institutions and international financial relations.

The macroeconomic explanation is ra-

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ther an obvious factor in that East Asia has had a very strong macroeconomic performance. When we talk of macroeconomic performance we mean high and stable growth rates, low inflation, high savings rates and current account surpluses. In all of these areas, East Asia has looked much better than Latin America, even when looking at the performance of individual countries of the two regions.

The strength and durability of institutions in East Asia has been an important factor in promoting financial growth. Measuring institutions can be difficult but usual indicators would relate to government effectiveness, regulatory quality, the rule of law and anti-corruption.

Lastly international factors also contributed to promoting financial growth. Latin America in this respect has made greater use of international finance. While this has created some benefits like greater volumes at cheaper prices, it has also created some volatility and foreign borrowing undermines some elements in the domestic market, particularly small and medium-sized firms.

### **Eastern Europe Comparison**

Turning to Eastern Europe, comparing this region with East Asia and Latin America poses some difficulties in this analysis. While the macroeconomic explanation still holds, Eastern Europe actually has stronger institutions when compared to East Asia and Latin America. It also has a large share of foreign capital coming mainly from Western Europe. In fact, its relationship with Western Europe and in particular the EU is a strong factor for the

region having stronger institutions and attracting more foreign capital. As countries in Eastern Europe geared up to join the EU, they were required to implement strong institutional reform and development. And as they integrated themselves with the EU, foreign capital flowed in as the region was increasingly seen as safe and a place of new opportunity. This shows us that for Eastern Europe, the relationship it has with the EU has been fundamental towards its growth.

### **Implications for the Future**

What implications does all of this have for future development? The first and most prominent is that a lack of finance undermines growth. All three regions have shown how finance can be the catalyst for growth. Yet international finance can bring with it some problems that can, in some cases, lead to crises.

And this can be transformed into some policy implications too. A return to a domination of state-owned banks is not the way to go forward but we can see now that the state does have an important role to play in this area. Regulation is also important. For example there has been talk of drawing up rules on the movement of foreign capital which may go some way to alleviating strains on developing economies.

With all its successes and the way it has overcome adversities, East Asia has many lessons for Latin America and Eastern Europe, if not for the US and Western Europe. Its experiences in the financial crisis of 1997 can hold valuable lessons.

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## Discussion

### *Regional Approach to a Global Crisis*

The recent discussions on the Chiang Mai Initiative have shown the desire to go for a regional approach towards dealing with what is a global crisis. The CMI will increase East Asia's bargaining position on the international stage and we see that in the way they have tried to maintain an Asian membership and a degree of independence from the IMF. This kind of approach is about self-finance, first you borrow nationally and then you borrow regionally. It depends on what solution you take for what crisis you are dealing with.

### *The Path of Financial Liberalization*

Financial liberalization has important implications for growth. We have seen the progress in East Asia, Latin America and Eastern Europe with liberalization. Amidst the current financial crisis, questions have been raised about the extent of financial liberalization. In this regard, some important points need to be mentioned. There needs to be a middle ground between full liberalization and partial liberalization. It is also critical to note, and past lessons have taught us this, that financial liberalization done poorly can create a crisis. Better regulation can deal with this. But there also need to be a realization that sometimes private ownership is not always the “be-all and end-all” in finance.

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age themselves efficiently have more options when confronting difficulties.

### *Motivations for a Regional Comparison*

It is important to recognize that whether comparing regions or comparing nations both have merits of their own. However, we can see increasingly today that regions tend to cluster and operate together as a single actor on the international stage. Still we must be always careful in how we approach an analysis of a region.■

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