



Technical Assistance Report

Project Number: 42502
Research and Development Technical Assistance (RDTA)
December 2008

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

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
DMC	–	developing member country
G-20	–	Group of 20
TA	–	technical assistance
TED	–	T-bill and eurodollar

TECHNICAL ASSISTANCE CLASSIFICATION

Type	–	Research and development technical assistance
Targeting Classification	–	General intervention
Sector	–	Finance
Subsector	–	Banking systems, capital markets and funds, finance sector development
Themes	–	Sustainable economic growth, regional cooperation, capacity development
Subthemes	–	Promoting macroeconomic stability, promoting economic efficiency and enabling markets, sharing information and knowledge, institutional development

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The ongoing global economic and financial crisis has underscored the importance of maintaining the stability and soundness of financial and economic systems across the globe. In an increasingly interlinked global economy, distress in one market can easily spill over to the world's financial markets and into the real economy. Asia, which earlier appeared relatively immune to fallout from the financial crisis, is now facing greater risks due to the global slowdown. Recent discussions at the Group of 20 (G-20) Summit¹ highlighted the need to take decisive and bold actions at the individual country level as well as to closely coordinate across national boundaries to counter the scale and global nature of the crisis.

2. The global economic and financial crisis is impacting South Asia at a time when it was already preoccupied with the adverse effects of a severe terms-of-trade shock (reflected in a worsening of macroeconomic balances) and strong inflationary pressures. Policymakers in South Asia (as elsewhere in the world) now face the challenge of simultaneously coping with a sudden recession in most developed economies, a collapse in commodity prices, a severe liquidity crunch, and, most of all, loss of confidence. If the current crisis persists, its impact on growth is likely to be pronounced and could significantly delay the region's achieving its development goals toward poverty reduction and inclusive growth. Particularly for smaller economies in the region with large balance-of-payments and fiscal deficits, adverse impact to growth will be significant. Such countries will have larger financing and adjustment needs and if capital dries up, this will put a deep strain on the balance sheets of domestic firms and banks, potentially leading to a cascade of bankruptcies and bank failures. There is a growing consensus that much can and should be done to address weaknesses in South Asian financial systems as well as to restore growth and stability in the real economy. Despite its being the least financially integrated subregion, the global crisis confronts South Asia (in varying degrees) with daunting macroeconomic challenges.

3. Following the recently concluded joint Asian Development Bank (ADB) and The World Bank's South Asia Bond Markets Conference² in Hong Kong, developing member countries (DMCs) in South Asia suggested that ADB support for exchange of views and learning from experiences in the context of the evolving economic and financial crisis necessitate consideration particularly for smaller economies. Accordingly, the proposed research and development technical assistance (TA) project provides a forum for discussions among South Asian and other DMCs on national and regional responses to the crisis in dealing with systemic risks, identify mechanisms that could maintain financial stability and shore up investor confidence, and assist in designing and implementing fiscal and investment strategies and policies to stimulate the domestic economies. In-depth status papers will be prepared and international experts will be invited to facilitate knowledge sharing in the forums. The proposed TA will feed into broader interventions planned by the Asian Development Bank Institute. The design and monitoring framework is in Appendix 1.³

¹ The meeting of the G-20 leaders at the Summit on Financial Markets and the World Economy in Washington on November 15, 2008. The G-20 is a group of finance ministers and central bank governors from 20 economies, namely: Argentina, Australia, Brazil, Canada, People's Republic of China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russian Federation, Saudi Arabia, Republic of South Africa, Turkey, United Kingdom, United States, and European Union.

² ADB. 2008. *Small Scale Technical Assistance for South Asian Bond Markets Conference*. Manila (SSTA 6487 approved on 12 September 2008, for \$66,000)

³ The TA first appeared in the business opportunities section of the ADB website on 5 December 2008.

II. ISSUES

4. The bursting of the real estate bubble in the United States triggered the current global economic and financial crisis, resulting in unprecedented losses to financial institutions having either direct or indirect exposure to mortgages, including through asset-backed securities. These losses have considerably weakened financial structures that now necessitate government bailouts to prevent them from collapsing.

5. Although most Asian countries remain relatively closed economies, they nevertheless are exposed to the contagion effect of instability in global debt and equity markets that is leading to capital outflows, reduced capital inflows, and tightening credit in the international financial markets. Nonetheless, the risk exposure is not the kind that devastated many East Asian economies during the Asian financial crisis of 1998 to 1999. This may be attributed to the following (i) the current crisis is not of the homegrown variety but is an imported one; (ii) South Asian financial institutions' direct exposure to subprime-related structured products is relatively limited; (iii) countries in South Asia had undertaken reforms to strengthen prudential regulations and, in particular, risk management practices following the Asian financial crisis, including developing more resilient financial systems; and (iv) because South Asian countries' capital accounts are still not convertible, they are much less exposed to turbulence in global capital markets.

6. Asia's economic and financial systems have nevertheless come under pressure. As the global credit crunch intensified, Asia's main export markets in North America and Europe suddenly contracted. Repricing of financial risks has sharply deteriorated Asian equity values and external funding conditions. Contagion may affect the region's economies and financial systems more seriously if tightening credit conditions and financial instability affect broader economic activity within the region. In South Asia, signs of increasing stress are evident. T-bill and eurodollar (TED)⁴ spreads remain high in countries such as India and Sri Lanka. Trade financing is becoming scarce and various economies in the region face large and uncertain amortization of short-term debt. Tighter credit means less private investments in South Asia to finance priority development needs including infrastructure, health, education, and technological innovation, thereby posing a considerable threat to the region's long-term growth potential and ability to continue rapidly reducing poverty. Accordingly, it is important to facilitate an exchange of views on possible downside risks over the short to medium term, on measures that can reduce these risks, on how to develop domestic policies and programs to counter collapse of external demand, and on possible regional efforts to reduce the impact of global instability in South Asia. A summary assessment of the global economic and financial crisis is available as a supplementary appendix.

III. THE TECHNICAL ASSISTANCE

7. To address the evolving implications of the global economic and financial crisis in South Asia, the TA will engage South Asia and DMCs in the region to exchange views and explore ongoing and planned initiatives at country, subregional, and regional levels to address the crisis and the adverse impact on domestic economic and financial stability.

8. Specifically, this TA will engage participants in an open dialogue on the following issues:

⁴ The TED spread is the difference between the interest rates on interbank loans and short-term United States government debt ("T-bills"). The TED spread is an indicator of perceived credit risk in the general economy.

- (i) The impact of financial contagion on the economies of South Asia, across the macroeconomic (including gross domestic product growth, job creation, inflation, private and official capital flows, and the balance of payments) and financial sectors (including debt and equity markets).
- (ii) Policy responses that countries have adopted to address financial turbulence, as well as additional preventive and/or mitigation measures to be adopted should the situation deteriorate further. These could include monetary, exchange rate, and fiscal policy measures; prudential oversight of bank capital to improve liquidity management; and enhancing financial system surveillance while strengthening international best practices (including International Organization of Securities Commission principles, strengthened Basel II frameworks, and Financial Stability Forum principles).
- (iii) Impacts of the crisis on international private capital flows and domestic private investment and, therefore, on countries' overall investment programs, including in infrastructure development wherever public-private partnership is an important modality.
- (iv) The possible nature of domestic stimulus packages to counter adverse affects of lower external demand and of possibly declining private investment and capital inflows.
- (v) The regional dimension of the crisis and, in particular, of the deepening financial contagion, while recognizing that investor sentiments can easily spread across boundaries, ensuring that protectionist policies are avoided at national level, and avoiding other negative externalities for the region.
- (vi) Mechanisms that can supplement in-country systems in helping maintain stability in financial markets and resolve localized crises.
- (vii) The need for enhanced assistance from multilateral institutions, and its nature, so as to provide the necessary intervention in the most effective manner.

A. Impact and Outcome

9. The TA's impact is to help provide (i) knowledge and sharing of in-country and global experiences to minimize the adverse effects of, and cope with, the global economic and financial crisis in the near term; (ii) relevant information that could be used by policymakers to design policies for the real sector to preserve sound economic growth and maintain investments in priority areas such as infrastructure development; and (iii) a foundation for more stable financial systems in South Asia by building on opportunities from the current market turbulence to facilitate exchange of information and views on resolution measures and develop international best practices across the region's financial markets. Overall, the TA will catalyze domestic and regional efforts in addressing possible impacts of the global economic and financial crisis on South Asian DMCs.

10. At the domestic level, the TA will build South Asian DMCs' capacity for addressing systemic vulnerabilities in their financial systems; identify mechanisms for dealing with systemic risks and avoiding financial instability, including possible multilateral support; open dialogue on a continuing basis among policymakers, regulators, and practitioners regarding possible reforms for enhancing governance, regulatory, and supervisory practices, as well as financial structures; and help bring these practices and structures into line with international best practices.

11. At the regional level, it will help identify mechanisms for dealing with the contagion effects of financial crisis and strengthening coordination among regional partners for regional crisis management and liquidity risk management.

B. Methodology and Key Activities

12. The TA has four components, with key outputs and activities as follow:

- (i) **Component 1.** Organize a 2-day conference with the participation of South Asian policymakers, market participants, and other interested groups.
 - (a) First, to gain an understanding and perspective on the global economic and financial crisis—its root causes, how to deal with risks in the near term, and how future crises may be prevented. Key outputs include but are not limited to (1) identifying and understanding actual-to-date and potential future direct and indirect impacts of the ongoing global crisis on various categories of emerging market economies (e.g., categorized by openness to global economy and role of international trade, size, stability, and openness of the financial system, commodity exporters vis-à-vis importers); (2) assessing and addressing the direct and indirect impacts of the global crisis on individual South Asian economies (including extent to which potential risks facing DMCs can be addressed by their own actions and which risks can be mitigated only through joint actions at the G-20 or intermediary levels; (3) identifying specific country measures that can be undertaken immediately to stabilize the situation, drawing from measures already taken by other countries (especially the G-20) to revive their respective economies and financial systems; and (4) discussing long-term measures necessary to insulate existing systems from such systemic risks.
 - (b) Second, to provide a forum for South Asian DMCs to share cross-country experiences while focusing on (1) assessing the impacts of likely crisis scenarios on their respective financial systems and real economies, (2) preparing a strategy or road map of measures and mechanisms to offset adverse effects of the crisis on their respective markets and economies, and (3) identifying financial and technical support needed.
- (ii) **Component 2.** Organize a follow-up 2-day conference to discuss means of enhancing financial stability in the region to include South Asian policymakers, market participants, and external regional associations (as observers) toward the following.
 - (a) First, a discussion of alternative mechanisms and measures that DMCs within the region can implement, including, among others (1) monitoring of systemic risks. This can include such measures as establishing a surveillance mechanism to detect signs of an emerging problem or early warning systems; and (2) maintaining regional and domestic financial stability by addressing short-term liquidity difficulties in the region and supplementing the existing international financial arrangements.
 - (b) Second, formation of a working group to review the various proposed regional arrangements and mechanisms, and the feasibility of their implementation.
- (iii) **Component 3.** Conduct a 2-day workshop to discuss the findings and proposals formulated under the coordination mechanism. Resource persons and economic experts will be invited to provide inputs in addressing the problems and

challenges leading to implementation of the proposed arrangements. A working group report will be prepared outlining the proposed initiatives.

- (iv) **Component 4.** Hold meetings involving high-level policymakers and regulators to discuss the possibility of national and possibly regional programs and arrangements, including any special programs to be put in place by multilateral institutions, including the ADB.

C. Cost and Financing

13. The TA's total cost is estimated at \$800,000 equivalent. It will be financed on a grant basis by ADB's TA funding program. The cost estimates and proposed financing plan are in Appendix 2. No activity will be financed in any member country under this TA, unless and until a letter of no objection in respect of such activity has been received from the government of such member country.

D. Implementation Arrangements

14. ADB will be the Executing Agency for the TA. The South Asia Regional Department, along with the Central West Regional Department and the Office of Regional Cooperation and Integration, will implement the TA. A joint implementation group comprising these departments will be formed. The TA will be implemented within nine months from the date of its effectiveness, from December 2008 to August 2009. Given the tight time frame for implementing the TA, ADB will recruit international consultants through a single-source selection of a firm and will engage the services of reputed international economists and resource persons in accordance with ADB's *Guidelines on the Use of Consultants* (2007, as amended from time to time). The terms of reference for consultants and resource persons are in Appendix 3. Disbursements under the TA will be made in accordance with the ADB's *Technical Assistance Disbursement Handbook*.⁵

15. The TA is expected to commence in January 2009 with the engagement of consultants to prepare three background papers and context issues on the global financial crisis and the vulnerabilities in the financial system and real economies of South Asian DMCs. The consulting firm will also be responsible for planning and organizing logistics, administration, and delivery arrangements to execute the TA, which will include but not be limited to (i) preparing the background papers; (ii) organizing advisory group meetings for selecting topics and agenda; (iii) acting as secretariat for the coordinating mechanisms set up during component 1 and preparing background papers for subsequent meetings under components 2, 3, and 4 in consultation with the individual international economists and resource persons; (iv) publishing and disseminating information, papers, and reports on the conferences and workshop and facilitating the network of key delegates and participants; and (v) moderating the conferences and/or forums.

IV. THE PRESIDENT'S DECISION

16. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$800,000 on a grant basis for the South Asia Forum on the Impact of Global Economic and Financial Crisis, and hereby reports this action to the Board.

⁵ ADB. 2008. *Technical Assistance Disbursement Handbook*. Manila.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>Impact South Asian developing member countries (DMC) cooperate in implementing measures to address the impact of the financial and economic crisis</p>	<p>Improved policy, regulatory, institutional, and organizational frameworks</p> <p>Strengthened coordination at the subregional/regional level</p>	<p>Policy, legal, regulatory and economic reports from the DMCs</p>	<p>Assumption South Asia DMCs and regional partners agree on a common agenda</p> <p>Risk Continued volatility in financial markets due to systemic risks that threaten the region's long-term growth; and political concerns that compel DMCs to look inwardly and consider political solutions to their problems.</p>
<p>Outcome A working group of South Asian policymakers discussing and identifying measures and external support needed to address financial vulnerabilities</p>	<p>Proposals aimed at addressing economic and financial vulnerabilities</p> <p>Proposal on reforms on policy, national regulatory, legal, and financial systems</p>	<p>Working group reports</p>	<p>Assumption Commitment of DMC governments to address the adverse impact of the crisis on economic and financial systems and establish long-term systemic solutions</p> <p>Risk DMCs fail to take initial steps towards forging formation of a subregion/regional working group</p>
<p>Outputs</p> <p>1. Country-level strategies and measures to address financial vulnerabilities identified</p> <p>2. Appropriate measures from development partners to assist DMCs to address financial vulnerabilities identified</p>	<p>List of proposed country-level strategies and measures</p> <p>List of proposed financial and technical assistance packages</p>	<p>Working group reports</p> <p>Working group reports</p>	<p>Assumption DMC representatives and participants' commitment to participate and engage in an open dialogue and consultation</p> <p>Risk DMCs send representatives to meetings who do not have sufficient authority</p>
<p>Activities with Milestones</p> <p>1.1 Two-day conference with participation of South Asian policymakers, market participants, and other interested groups (January/February 2009)</p> <p>1.2 Two-day regional conference to discuss means to enhance regional financial stability and regional cooperation (with participation of South Asian policymakers, market participants, and external regional associations (as observers) (March/April 2009)</p> <p>1.3 Two-day workshop for the working group to finalize its recommendations (June 2009)</p> <p>1.4 Meetings involving high-level policymakers to discuss implementing the regional arrangements from the working group report (July 2009)</p> <p>The programs outlined above are proposed to be implemented within nine months from technical assistance effectiveness.</p>			<p>Input</p> <p>Asian Development Bank contribution from Technical Assistance Special Fund: \$800,000.</p>

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Total Cost
Asian Development Bank Financing^a	
1. Consultants	
a. International Consultant and Economists	125.0
b. Resource Persons	50.0
c. International Travel	55.0
2. Workshops and Conferences	
a. Travel, Accommodation, Conference, and Workshop-Related Costs of Official Delegates	320.0
b. Preparation of Background and Economic Papers ^b	100.0
c. Printing and Dissemination	35.0
3. Miscellaneous Administration and Support Costs	35.0
4. Contingencies (10%)	80.0
Total	800.0

^a Financed by the Asian Development Bank's technical assistance funding program.

^b Based on estimates provided by an international consulting firm.

Source: Asian Development Bank estimates.

OUTLINE OF TERMS OF REFERENCE FOR CONSULTANTS

1. Given the tight time frame for implementing the research and development technical assistance, the Asian Development Bank (ADB) will recruit international consultants through a single-source selection of a firm, and will also engage the services of international economists and resource persons in accordance with ADB's *Guidelines on the Use of Consultants* (2007, as amended from time to time).

A. International Consultant

2. The international consultant recruited through single-source selection of a firm will provide expertise and help execute the following scope of work:

- (i) Undertaking conference preparatory activities, which include
 - (a) preparation of a background and context issues paper on (1) the global financial crisis and its direct and indirect impacts on various groups of emerging economies, (2) likely direct and indirect impacts specifically on South Asia at both country and regional levels, and (3) issues for discussion during the forum;
 - (b) holding of advisory groups meetings for developing conference and/or workshop agendas, program, special events, etc. in coordination with ADB;
 - (c) provision of secretariat services to any working groups or of any other coordinating mechanism agreed to carry out the work under components 2, 3, and 4; preparation of their draft reports and proposals;
 - (d) identification, selection, invitation, and confirmation of key delegates and participants, including keynote speakers and discussants, in coordination with ADB;
 - (e) logistics, site planning, and preparation, including a hosting plan and various administrative requirements;
 - (f) preparation, printing, and dissemination of a background paper on the conference and/or workshop agenda for all participants prior to the conference; and
 - (g) administrative arrangements, including travel and accommodation requirements, liaison arrangements, and hosting plan.
- (ii) Managing actual conference and/or workshop activities, including:
 - (a) on-site registration and venue management;
 - (b) moderating the sessions, including presentation of the background and context issues paper to kick off the conference and of the closing presentation; and
 - (c) conducting the conferences and workshops within budget.
- (iii) Undertaking post-conference activities and/or services, which include:
 - (a) compilation of presentation materials and keynotes for distribution to all participants;
 - (b) preparation of a high-level assessment paper incorporating the key discussion points, the feedback and key takeaways, the outcomes and recommendations; and
 - (c) presentation of the findings and recommendations to ADB.

3. The consulting firm will have the required expertise and experience in managing international forums of public and private sector leaders in the area of policy and strategic

advisory. Key consultants engaged by this consulting firm will have (i) substantial knowledge and advanced qualifications in finance and economics, (ii) proven knowledge and extensive work experience on regional cooperation integration issues in South Asia, and (iii) solid experience in similar assignments involving the preparation and managing of conferences on issues related to regional financial development.

B. International Economists (two for approximately 2 person-months each)

4. Two economists will be engaged to prepare country assessments or diagnostic studies on South Asia and how vulnerable are those countries' financial systems to systemic risks. They also will assist in formulating feasible national and any regional coordinating arrangements that can be agreed amongst the parties.

5. The economists will have (i) advanced degrees in economics, finance, and/or international relations; (ii) proven knowledge and extensive work experience in preparing high-level economic papers; (iii) extensive experience working on regional cooperation and integration issues in South Asia; and (iv) extensive experience working with international financial institutions.

C. Resource Persons (six for 5 person-days each)

6. Six economists and finance experts will be engaged as resource persons to participate as discussants in each of the conferences and forums under the four components of the technical assistance.