

## **A Strategic Priority for Emerging Markets**

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**T**o introduce this symposium, I would like to share with you a few of the painful lessons that IFC has learned from the recent crises in emerging markets. These lessons have made it absolutely clear that the development of local debt markets is more urgent and critical than ever. However, we also need to discuss the complexity and difficulty of this undertaking. Last, I would like to say a few words about how IFC can work with you and help you in this process of developing local debt markets.

Things are getting better in the emerging markets, but I would be very cautious about declaring victory. We have yet to see investors and lenders coming back to the vast majority of these markets in what I would call a meaningful way. Some of the best companies in Latin America and Indonesia are still struggling to gain access to the international markets. Unfortunately, some of the reform programs that are under way may never be seen through to completion. This will only increase the vulnerabilities that we have seen in those markets.

The first lesson that we have learned from this crisis is that foreign exchange exposures can be devastating, not only for the corporations and the financial institutions that have taken those exposures, but also for the rest of the financial system. Second, the recent crisis has shown us that foreign capital flows can be extremely volatile. The risk of liquidity and maturity mismatches can be very acute and is a source of systemic risk. In 1997 the net capital flows to the de-

veloping countries reached about US\$300 billion. By 1998, one year later, these were down to US\$200 billion, with the bulk of the reduction coming from lenders calling back their short-term loans. Indirect investments made by strategic investors remained stable at about US\$150 billion. This shows that short-term loans had been financing long-term investments, and when lenders decided to withdraw those loans, they caused havoc in the markets. I do not think any market would have been able to survive this type of withdrawal, which demonstrates that maturity risk is very real. The third lesson concerns the future financing of some new sectors that have been privatized and liberalized, namely, the infrastructure sectors. I have no doubt that such liberalization and privatization can bring—and has brought—substantial benefits to the countries concerned, to the consumers in those countries, and has significantly improved the competitiveness of those economies. However, it would be very naive to believe that the huge and unmet demand in those sectors can be met by foreign capital flows alone. Prudent risk management requires the development of the financial sector. The development of the financial sector goes hand in hand with the need for a substantial mobilization of local savings, with a key role for the local debt market and local stock market. The same conclusion can be drawn for another very important sector in the social area, the housing sector.

Another reason for working on developing local debt markets is to meet the growing needs of pension funds by providing long-term, local currency liabilities. The recent crisis highlights the need to accelerate the development of local debt markets, but progress has been excruciatingly slow in many countries. They face many challenges in this regard. They need to create a supportive stable macroeconomic environment and not crowd out the private sector with government borrowing. They must also build a prudent and transparent market with proper regulation and efficient and reliable infrastructure; in addition, they must create active and capable market participants. We have all learned that building market infrastructure is not the same as building a market. It does not ensure market participation: issuers, investors, and intermediaries need to see an economic benefit to being in these markets, and they need to be allowed by regulation to be in these markets. They also need to be able to operate capably, prudently, and effectively.

These are difficult challenges that require time and effort in order to be able to meet them. They require active input and commitment from policymakers, regulators, and market participants, who together must set the goals and gain consensus on how to move forward and implement the steps that must be taken to achieve these goals. Those addressing these challenges can also benefit from learning from each other: sharing each other's experiences, successes, frustrations, and solutions across countries and across regions. Many emerging markets have already made some progress in developing their local debt markets. Representatives from two countries outside the South Asia region, from Korea and Malaysia, will share with us their experiences.

For IFC, the whole question of local debt markets is a strategic priority. We shall do our best to continue assisting both regulators and market participants in the development process. We stand ready to help countries decide on the most appropriate instruments for them to develop while bearing in mind that our member countries are not all at the same stage of development and that their needs may be quite different. IFC will continue to provide technical assistance on policies and regulations and on the establishment of regulatory bodies, helping the relevant authorities better understand the market participants' perspective. Through our investments in credit-rating agencies, in securities firms, and in institutional investors such as mutual funds, insurance companies, and pension funds, we will bring not only capital, but also best practices to our clients. This will also have an effect, we hope, on the development of other institutions and other companies in the relevant markets. We can also help support the development of local bond markets by issuing our own paper. We could also work on credit-enhancing bond issues and domestic bond issues, and on helping to invest in securitization vehicles. We hope that the presence here at the symposium of both regulators and market participants will help each country achieve the purpose of the symposium, which is to develop a road map for removing the obstacles that are constraining the development of their local debt markets.

Perhaps all of you can become the cornerstone of a regional coalition for development of local debt markets. Someone may want to create a web site on which to exchange views, answer questions,

share problems, and measure progress as you move ahead in this important effort. If this works, then a coalition such as this could later be expanded to other regions, such as Latin America, the Middle East, and Africa.