A note from the Editor

There is a strongly held view that more robust financial systems in East and South-East Asia, meaning financial systems with a wider spread and availability of institutions and of instruments, could have prevented, or greatly lessened the intensity of, the 1997 crisis in Asia. Financial systems in the crisis economies – and, indeed, elsewhere in the region – consisted largely of commercial banks with some merchant/investment banking functions as 'add-ons' and specialized banks for lending long term. There were thriving equity markets but no domestic bond markets. In other words, with most funding of long-term operations done by bank loans the financial sector in these economies had taken on large, unhedged, maturity mismatch risks in the event of problems with debt service by borrowers. Moreover, if the liabilities were denominated in a foreign currency and assets in the domestic currency, there was a foreign currency risk explicit in the event of a major exchange rate depreciation.

Now, in the context of another downturn, there is renewed interest in how to pre-empt large cyclical downturns from effectively reducing overleveraged corporations to bankruptcy in the process *and* simultaneously reducing the banking system to insolvency. If developed economies are a guide, the answer appears to lie in building domestic bond markets to help corporations diversify their sources of financing and lock in local currency, fixed rate, long-term funding by issuing debt finance rather than borrowing from the banking system. The credit risk would be transferred from the banking system to the holders of the debt instruments. But even if the direction of causation in establishing bond markets was unequivocally known, i.e., whether they are primarily demand or supply-driven phenomena, bond market development raises a host of difficult issues for most economies in the Asian and Pacific region. Quite apart from the problem of benchmarks where little or no public debt exists, the message from the articles on bond market development in the Pacific Rim, in Singapore and the case study on the development of bond markets in India is that building bond markets is difficult, takes a lot of time and is not a realistic policy for most countries in the region.

A subsidiary theme is the role of small and medium enterprises (SMEs), in today's world of ever-changing technologies and market conditions and immense production and supply networks dominated by transnational corporations. How does one nurture the growth of SMEs from being primarily subcontracting agents for much bigger corporations to operations where economies of scale become relevant? There is no clear-cut answer. As far as the evidence is concerned, some SMEs have been more successful in grasping the opportunities that have come their way than others. The reasons are only partially institutional. They are more likely to do with the inherent weaknesses of family-run enterprises. From an analytical perspective conjectures are not enough. SMEs suffer from major gaps in information as regards their operations and the strength of their balance sheets. This is a significant constraint on the development of better policy options for SMEs, especially, say, improving access to both long-term and short-term finance for them, often singled out as an impediment to their growth. The article on SME subcontracting as a means to enhanced competitiveness seeks to highlight the problems of what, in the ultimate analysis, is the principal employment-generating sector in both developed and developing economies. Finally, an article on the inter-linkages between human resource development and attracting foreign direct investment (FDI) from the perspective of Malaysia, Thailand, Indonesia and the Philippines comes to the unsurprising but valid conclusion that good quality human resources are central to the attractiveness of an economy as far as FDI is concerned. Readers may wish to respond to the articles in this issue of the *Journal* with comments as they see fit.

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