The Global Financial Crisis and the Asia-Pacific region

A Synthesis Study Incorporating Evidence from Country Case Studies

Ajay Chhibber, Jayati Ghosh and Thangavel Palanivel

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23 Independence Avenue, Colombo 7, Sri Lanka.

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Table of Contents

01	**Introduction**	**01**
02	**Asia's Integration with the Global Economy**	**09**
03	**Lessons from the Recent Past: The Experience of Countries After Economic Crises**	**15**
04	**The Current Crisis: Macroeconomic Transmission Mechanisms**	**27**
4.1	The Broad Trends	27
4.2	Merchandise Exports	29
4.3	Services Exports	33
4.4	The Impact of Capital Outflows and Financial Turbulence	35
4.5	Exchange Rate Changes	38
4.6	Remittances	39
4.7	The impact on government fiscal positions	42
05	**Volatility in International Commodity Prices, especially of Food and Fuel**	**47**
5.1	Causes of global price volatility for food and fuel	48
5.2	Effects through External Trade	52
5.3	Domestic pass-through of prices	57
06	**The Social Impacts of the Crisis**	**65**
6.1	Employment patterns	65
6.2	The Crisis and Agriculture	70
6.3	Impact of Reduced Access to Credit	71
6.4	Impact on Migrant Workers	72
6.5	Impact on Income Poverty and Human Poverty	72
07	**Policy Responses**	**77**
7.1	Fiscal and Monetary Policies	77
7.2	Financial Regulation	84
7.3	Redirecting production and demand to resolve external and internal imbalances	85
7.4	Supporting agriculture and promoting faster rural development	88
7.5	The significance of social protection	89
7.6	Policies for substantial and equitable future growth	98
References		**100**
•	UNDP Country case Studies References	100
•	Other References	101
Annex 1		**106**
Annex 2		**109**

List of Charts

- Chart 1: GDP Growth, Savings and Investment Rates in Korea, Indonesia, Malaysia, Thailand and the Philippines 18
- Chart 2: Economic Crisis and Poverty Rate 21
- Chart 3: Inequality and Crisis (Gini Coefficientant) 22
- Chart 4: Growth Rates of Real GDP have been more Synchronised than ever before 27
- Chart 5: Quarterly real GDP growth (%) turned Negative in 6 of 10 Asian Economies by 2008 Q4 28
- Chart 6: Changes in World Trade Values and Volumes (yoy basis) 29
- Chart 7: Exports Collapsed in Asia since Sep 2008, but recovering slowly 30
- Chart 8: Trade balance 30
- Chart 9: Though exports have slumped quite sharply, Current account balances as % of GDP remain quite strong 31
- Chart 10: Trade linkages in emerging Asia 33
- Chart 11: Soundness of Banking Systems in Asia-Pacific 36
- Chart 12: Equity markets 38
- Chart 13: Index of nominal exchange rates 39
- Chart 14: Remittance Inflows in Bangladesh, Pakistan and the Philippines 41
- Chart 15: Food and Fuel Prices declined due to GFC, but increasing once again 47
- Chart 16: The imbalance in the world oil consumption and supply increased since 2003 52
- Chart 17: Index of manufacturing employment 66
- Chart 18: Coverage of Social Protection 90
- Chart 19: Social Protection Expenditure during 2004-05 in Asia and the Pacific 97

List of Tables

- Table 1a: Impact of past crises on education varies depending upon the level of economic development 22
- Table 1b: Impact of past crises on child health and nutrition varies depending upon the level of economic development 23
- Table 2: Asian export exposure to developed countries (as % of GDP) 31
- Table 3: Direction of exports (% of total exports) 32
- Table 4: Rate of growth of tourist arrivals and tourism receipts (% per year) 34
- Table 5: Financial exposure to the US markets has increased over the period 37
- Table 6: Share of "Top Seven" in Asian emerging market external financing 37
- Table 7: Migration status of Asian countries 40
- Table 8: Most Asian countries now follow countercyclical fiscal policy 43
- Table 9: Many Asia-Pacific countries are net food and agricultural importers in 2004-05 (two years average) 53
- Table 10: Many Asia-Pacific countries are net food and cereals importers in 2003-08 (Five years average) 54
- Table 11: Food import dependency during 2003-07 55
- Table 12: Only one fifth of Asia and the Pacific countries net food grains exporters during 2003-08 56
- Table 13: Pass-through coefficients for food prices varied significantly across countries during 2006-08 57
- Table 14: Pass-through coefficients for oil prices vary significantly across countries as well as between diesel and gasoline during 2006-08 58
- Table 15: Percentage increase in the food cost (due to increase in cereal prices) of poor households is much higher than that of rich households during 2006-08 60
- Table 16: Percentage decrease in purchasing power (due to increase in cereal prices) of poor households is much higher than that of rich households during 2006-08 61
- Table 17: Employment elasticity is low and declining in Asia-Pacific 67
- Table 18: Availability of policy space 77
- Table 19: Interest rates in selected economics in the last three years 78
- Table 20: Summary of policy actions taken in North America, Europe, Asia and the Pacific 79
- Table 21: Fiscal stimulus and support to the financial system in selected economies 81
- Table 22: An overview of social protection systems in Asia and the Pacific 89

Preface

It is now more than a year since the global financial/economic crisis erupted. This crisis affected Asia-Pacific developing countries through two main channels-financial and economic. The volatility of global prices, especially those for food and fuel, has also played a role, affecting both commodity exporters and importers in the region in different ways. The looming threat of climate change and the recent experience of increased natural disasters also pose a huge threat to the Asia-Pacific region. There was already evidence that some Asia-Pacific countries were lagging behind in the MDGs time schedule, even in the period of strong GDP growth. With the deceleration of growth, progress on MDGs is likely to be further derailed. In the last three months, however, there have been some signs of economic recovery in many countries including the larger Asian economies. Unfortunately, food and fuel prices have also started to rise along with this.

Against this backdrop, in March 2009, UNDP Asia Pacific Regional Centre, Colombo Office (UNDP/RCC) launched a Regional Initiative on the Global Financial and Economic Crisis in collaboration with UNDP/RBAP, UNDP/BDP and UNDP-Country offices (COs) in Asia-Pacific. The objectives of the initiative include but are not limited to (1) identifying and understanding the impacts of the global financial and economic crisis in the region; (2) assessing the impacts of the global crisis on individual countries; (3) identifying specific country measures that can be undertaken immediately to stabilize the situation, and protect vulnerable and poor, and long-term measures to achieve a rapid pro-poor growth in a sustainable manner; and (4) organizing regional/sub-regional/national policy forums to share cross-country experiences and identifying needs for technical and policy advisory support.

In this context, as a first step, UNDP Asia Pacific Regional Centre, in partnerships with UNDP Country Offices, UNDP-HQ (RBAP and BDP) and other UN agencies such as UNICEF undertook a series of policy–oriented country case studies (Bangladesh; China; Cambodia; India; Indonesia; Lao PDR; Philippines; Malaysia; Maldives; Mongolia; Nepal; Thailand; Sri Lanka and Vietnam) in Asia and the Pacific with the aim of understanding the impact of (and policy responses to) the global financial and economic crisis. The objective of this publication is to bring together the main findings of the above mentioned country case studies and other relevant studies conducted by various international organizations and research institutions in a coherent manner and to serve as an important advocacy and dissemination tool.

This synthesis study, which summarizes the impacts of the crisis and policy responses to the crisis over the past one year, has shown that initially Asia-Pacific was affected severely from the crisis. Trade and financial flows collapsed in almost all countries. Output contracted more severely in many Asian economies than even those nations at the epicentre of the crisis. But starting from the mid-2009, the region is recovering fast. Since the rest of global economy is expected to recover slowly, unlike the Asian crisis in late 1990s, this time Asia cannot rely on an export-led recovery. In this regard, by drawing from a diverse range of settings within the region, the study offers compelling insights into the importance of making growth more

inclusive and balanced as well as reasons for a new development paradigm needed for both recovery from the crisis and making the 21st Century as the Asian Century. The key findings and policy recommendations of the study serve as a useful source of information and ideas to policymakers in prioritizing and mitigating measures to address the impact of the crisis, and a stimulus for discussion, innovation and regional cooperation as countries strive to achieve the MDGs and build a brighter future for all.

In recent years, UNDP in Asia-Pacific has been increasingly working upstream towards fostering advocacy, policy advice and dialogue. It is hoped that this publication will provide new impetus to debate on how Asia-Pacific countries can further integrate MDGs and equity concerns into their national policy making and development strategies and develop practical options for promoting growth with equity. It is hoped that the independence of views and the professional competence of the authors ensure that the conclusions and recommendations will have the greatest possible audience and that the country case studies will be read with great interest.

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Authors

Ajay Chhibber is the UN Assistant Secretary-General and Assistant Administrator at the United Nations Development Programme (UNDP) and Director of its Asia-Pacific Bureau. Prior to that, he worked at the World Bank for almost 25 years on a range of development issues, managing its programs in Vietnam and Turkey, and in Indonesia and the Pacific. He was the lead author of the seminal work on Governance at the World Bank and the 1997 World Development Report on the Role of the State. He has published widely including five books on economic development and many articles in international journals and in major newspapers. He has a Ph.D from Stanford University, a Masters from the Delhi School of Economics and has worked at the Indian Planning Commission and at the International Food Policy Research Institute. He has also taught economics at Georgetown University and the University of Delhi.

Jayati Ghosh is a Professor of Economics at Jawaharlal Nehru University, New Delhi; Executive Secretary of IDEAs (International Development Economics Associates), which is an international network of heterodox economists, and Founding Trustee of the Economic Research Foundation in New Delhi. She has been the Chairperson of the Commission on Farmers' Welfare for the Government of Andhra Pradesh in India and Member of the National Knowledge Commission reporting to the Prime Minister of India. She has written and edited a number of books, the most recent of which include (with C. P. Chandrasekhar) After Crisis: Adjustment, recovery and fragility in East Asia & Tracking the macro-economy and the market that failed: Neoliberal reforms in India. She also writes regular columns in several journals and newspapers in India.

Thangavel Palanivel is a Senior Advisor and Team Leader at the UNDP Asia-Pacific Regional Centre in Colombo, Sri Lanka. He provides technical and policy advisory support to countries in Asia and the Pacific on pro-poor economic policies (including growth, fiscal, employment policies), macro-econometric modeling and policy scenario analysis, economic & poverty assessment, emerging issues (food, fuel and financial crises), and formulation of national development plans/poverty reduction strategies. He also coordinates activities of the MDG Initiative at the UNDP Regional Centre. He holds a doctorate in Economics and has more than 20 years of research, programme management and policy advisory support experience. He has published several research articles on development issues in journals and other publications. He also worked at the Institute for economic Growth (Delhi), University of Pennsylvania (Philadelphia) and the United Nations University (Tokyo) and UNDP Regional Programme (Kathmandu).

CHAPTER 1

CHAPTER 1

Introduction

When the global financial crisis broke in mid 2008, there were at least two differing perceptions on its likely impact on developing Asia. On the one hand, there were arguments that developing Asia, particularly China and some other leading economies, were now effectively "decoupled" from economic growth in the developed countries, and could even emerge as alternative growth poles of the global economy to take up the slack left by the recession in the United States and Europe. On the other hand, it was argued that, as the most "globalised" region of the world through both trade and investment, and given the high dependence of its own growth on exports, developing Asia was likely to be directly affected by the downturn and the adverse impact would be quite extensive. In the event, one year after the collapse of Lehman Brothers led to the implosion of financial markets across the world, it appears that both perceptions were at least partially correct. The global crisis has indeed affected developing Asia adversely, and some countries have been especially badly hit. However, unlike many other regions of the world, on the whole, in developing Asia the crisis did not cause an overall decline in GDP but a deceleration of growth, and the subsequent "recovery" is also currently seen to be faster and more pronounced in this region. Asia is cyclically tied to the developed world but its long term growth rates are nevertheless much higher and can become de-linked from the growth of the developed world with appropriate policies. In any case, there is strong evidence that Asia is converging rapidly.

Financial crises are not new to the region: a decade earlier, some countries suffered what is now known as the Asian crisis of 1997-98, with capital flight and dramatic asset deflation resulting from an initial decline in export growth and shifting investor expectations. Almost all Asian developing countries adopted the export-led growth model. This approach worked well as the global economy grew, and wages costs stayed low because of the vast pool of surplus agricultural labour which migrated to the new factories established with large inflows of FDI. As a result Asia's most dynamic economies remained internationally competitive, their domestic consumption remained low and they were able to capture a growing share of world markets. Before 1997-98, both savings and investment rates were high in the export-oriented economies of the region; after the crisis, however, savings rates remained high but investment rates tended to fall because of the combination of reductions in public and private investment rates. This led to the peculiar situation of "excess" domestic savings even in relatively low or middle income countries in Asia, and to the holding of international reserves that were then sought to be placed in safe assets abroad.

As a result, globally the previous boom was associated with the South (especially developing Asia) subsidising the North: through cheaper exports of goods and services, through net capital flows from developing countries to the US in particular, and through flows

In most countries, because wages stayed low and agriculture was often neglected, rapid economic growth was associated with high and growing inequality.

of cheap labour in the form of short-term migration, which in Asia took the form of intra-regional migration from less developed to more developed or oil exporting countries. In this boom, domestic demand tended to be profit-led, based on high and growing profit shares in the economy and significant increases in the income and consumption of newly globalised middle classes, which led to bullish investment in certain non-tradable sectors like financial assets and real estate as well as in luxury goods and services. Therefore, while Asian growth was in general based on exporting to the developed world and running large current account surpluses, these were mostly generated by maintaining high savings rates but lower investment rates compared to levels witnessed before the Asian crisis. Growing trade linkages within Asia emerged because of the creation of investment-driven export platforms catering to developed country markets, with a high degree of interdependence of production processes. This helped smaller Asian countries benefit by supplying raw materials and intermediate products to leading Asian economies who were in turn exporting to developed country markets.

However, in most countries, because wages stayed low and agriculture was often neglected, rapid economic growth was associated with high and growing inequality, so that the high growth did reduce poverty but not by as much, had growth been more equal. Insufficient policy attention to rural areas and agriculture meant that an agrarian crisis emerged in many countries. Farming became increasingly fraught with risk, subject to growing volatility and declining financial viability, while non-farm work did not increase rapidly enough to absorb the labour force even in the fastest growing economies of the region. Meanwhile, competitive pressures and conditions of excess labour supply meant that wage shares of national income tended to remain low or decline, while employment tended to become more fragile and insecure despite the boom. Weak social protection and inadequate public spending on basic services meant that any shocks (whether in the form of natural disasters or economic crisis) were likely to cause more people to fall into poverty. This is why in many parts of developing Asia, the positive impact of what was seen as a successful growth model leading to the "spectacular rise" of the region in the global economy did not translate into better human development conditions and actual improvements in people's lives to the extent that could be expected. This is not to deny the very significant drop in poverty that occurred in some countries (most notably China and to a lesser extent in other Asian countries), but simply to note that the growth would have had an even bigger impact on poverty reduction if it had not been associated with rapidly increasing inequality.

In this context, the current global crisis has impacted directly across the Asian region through its impact on exports to developed markets, which declined sharply and created ripple effects in reductions in intra-Asian trade. At the same time, sharp reversals in capital flows, which could not be explained by changes in economic "fundamentals" within Asia, caused declines in asset values and created instability in financial markets. However, it is also true that the substantial clean-up of the banking sector and corporate balance sheets that had occurred in the wake of the Asian crisis, as well as a more cautious and calibrated approach to banking and financial sector reform in several countries, prevented extremely adverse financial effects and has allowed the region as a whole to recover faster from this crisis. Employment declined sharply in export-oriented sectors, creating negative multiplier effects across other sectors. The effects on social sectors and on human development conditions in general have been marked. The unfolding of the process in developing Asia in general and within particular countries is described in more detail in the chapters that follow.

Going forward, what is clear is that it is not really possible simply to rewind back to the world that existed before the crisis. Quite clearly, unsustainable global macroeconomic imbalances must be resolved. The US cannot and will not continue to be the engine of world growth through increasing import demand in the near future. This means that developing countries in general, and particularly those in developing Asia that continue to rely on the US and the EU as their primary export markets, must seek to redirect their exports to other countries and most of all to redirect their economies towards more domestic demand. Whether this will be possible of course still remains an open question.

Since so much of the trade of developing Asia was directed, either directly or indirectly, to the United States and the European Union, the collapse of imports in these countries, and particularly in the US, has had direct and extreme effects. These negative effects may well persist for several years, and competitive efforts to retain or increase export market shares on the part of developing countries are therefore likely to be counterproductive. However, it also creates new opportunities for diversion of trade to other markets and towards home markets in the countries of developing Asia, most of which still have to fulfil their development potential. The emergence of new production networks and linkages in developing Asia, particularly because of the recent rapid expansion of China and India, assumes particular significance given the volatility of trade and investment flows from the developed world. Greater trade integration within developing Asia may become an important avenue for future economic expansion of the region.

But while more focus on intra-Asian linkages may serve to redirect both trade and investment within the region in positive ways, overall developing Asia cannot seek to re-export its way to growth to the same extent as after the 1997-8 crisis in the near future. This in turn requires a shift towards domestic demand led growth particularly in the countries with economies large enough to sustain this shift. Such a shift can occur through public expenditure to provide more basic goods and services, more resources directed to rural areas as well as better social protection, in addition to directly redistributive strategies. Whether this is possible in a sustained way remains a big question mark on the strength of the recovery that has just started.

The global financial crisis has brought about international recognition of the dangers posed by volatile finance and the need to regulate finance in specific forms, including in commodities markets, in derivatives and in various new financial instruments and innovations that hide risk. While there have been some moves to regulate finance in the developed financial centres of the world, such moves are still halting, patchy and inadequate to address the fundamental problems that remain in the financial system, including skewed incentive systems and tendencies to periodic crises. Meanwhile, however, there is particular need for developing countries to be aware of the dangers of financial deregulation, to develop capital account management techniques that take into account the new international reality and to design domestic strategies for financial deepening and inclusion that are not prone to the same tendencies of volatility and fragility. In particular, the impact of financial speculation in causing very rapid and extreme movements in the prices of certain essential commodities such as food and fuel must be noted, because developing countries are forced to deal with the effects of these movements on real economic variables and living conditions.

Climate change and ecological degradation introduce an additional dimension to this process. The set of issues around climate change (the impact, the need for adaptation and mitigation, and the complex set of international distributional issues focussed on the

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need to reduce carbon emissions globally) are likely to become significant external constraints upon economic expansion in Asian developing countries if negotiations on this matter are not handled with care. Obviously, in most of the region, the development project is far from complete and will require an increase in aggregate emissions rather than a reduction. At the same time, it is also necessary for Asian developing countries to acknowledge that they cannot and should not aim for exactly the same trajectory of economic growth that has been followed in the west, as this is neither globally feasible nor sustainable. Developing Asia has an advantage because it can start on a much less carbon-intensive production and consumption path from this point, which is based on more equitable and sustainable resource use. Therefore, an Asian low-carbon growth model is clearly called for, which involves less environmental destruction and avoids over-exploitation of natural resources. This should by no means imply any denial of basic needs to all citizens, but rather a transformation of patterns of consumption and demand so as to be more equitable, less wasteful and more sustainable.

Obviously, given the size and diversity of the region, one analysis and one prescription will not fit all the countries, and therefore it is necessary to distinguish across different categories of economies. Based on pre-crisis economic conditions, transmission mechanisms of the crisis and differing ability to respond to the crisis, one can identify five broad categories of national economies in Asia and the Pacific:

- China, which stands alone by virtue of its size, significance and particular institutional features. The Chinese economy is still significantly different from other economies in the region because the government retains various levers to control macroeconomic processes (most of all control over the financial system and banking) which reduce its reliance on "traditional" monetary and fiscal policies. At the same time, while its trade to GDP ratio as well as foreign investment to GDP ratio are very high and growing, this global integration is occurring within a largely state-controlled institutional context. The large current account surpluses of China have been accompanied by large (but generally controlled) foreign investment inflows, leading to accumulation of foreign exchange reserves on an unprecedented scale. This has made it extremely susceptible to changes in global (especially US) demand but also gives it much greater flexibility to respond to the crisis. China also plays a major role in trade flows in the region and a growing (and potentially much larger) role in investment flows. Despite its recent rise, it should be remembered that China still remains a developing country with high spatial and vertical income inequality.

- East Asian newly industrialized countries (NICs) of South Korea, Malaysia, and Singapore, in addition to the newly industrialized economies (NIEs)[1] of Taiwan, Hong Kong and Macau. These are among the more developed countries/economies of the region, with high per capita incomes, high degrees of trade and investment integration with the world and extremely high export dependence. They have been sharply affected by declining exports, but have considerable fiscal space for aggressive countercyclical policy as they have low current fiscal deficits and external current account surpluses. In these economies financial deregulation has been extensive, and there is now a high degree of financial integration as well as substantial foreign ownership of financial institutions operating within these countries. These countries

1. Officially both Hong Kong and Macau are described as the Special Administrative Regions of China, and Taiwan as a Province of China.

tend to have more extensive social protection policies than elsewhere in the region.

- India, Indonesia, Thailand, Vietnam, the Philippines, Pakistan and Sri Lanka. These are emerging and relatively small economies in terms of share of global GDP, notwithstanding their large populations. They are also at lower stages of development with dominantly poor populations. Their recent export growth (even in the case of India, other than for India's service exports) is essentially part of a manufacturing nexus that is increasingly oriented towards China as the hub for ultimate export to developed markets. Several economies are also extremely dependent upon remittance inflows. These economies were all running current account deficits and somewhat larger fiscal deficits before the crisis broke, and were to greater or lesser degree dependent on foreign capital inflows for at least a part of their recent growth. With the exception of Vietnam, recent growth has also been unequal, and associated with agrarian difficulties and poor employment generation. Material conditions have been affected by the rise in food prices even before the onset of the financial crisis. These countries face the crisis with less available freedom in terms of policy space. Other than Indonesia which has a high degree of financial integration and associated fragility, financial liberalisation has been less extensive than in other countries. Pakistan and Sri Lanka are extreme cases within the group, as they have had to turn to the IMF for emergency external funding with associated restrictive conditions on policy.

- Low-income countries such as Bangladesh, Cambodia, Bhutan, Lao PDR, Mongolia and Nepal. These are countries that have increasingly integrated with the global and regional economy through trade linkages, although for various reasons investment integration has remained limited. Four of them are landlocked, and in all of them the share of poor is large. While the previous growth story varies across such countries, in general they have been less directly affected by the first-order effects of the crisis other than through some declines in commodity prices, exports and tourism revenues. However, the available policy space tends to be more limited in these economies because of their small size and high dependence upon capital flows.

- Small island economies in the Pacific and the Indian Ocean. These tend to be extremely vulnerable because of their undiversified economies, with high dependence upon tourism and capital inflows, especially in the form of foreign aid, as well as reliance upon food imports.

The arguments outlined above are elaborated further in this study, which examines the effects of the global financial crisis on the economy and conditions of human development in Asia. While the analysis is of the recent past and of current conditions, the focus is on the future and on what can be done: the appropriate and desirable policy responses, the scope for public action in different developing countries that are already or newly constrained by foreign exchange gaps, the implications of different types of public action. In the next chapter, the overall context of global economic integration and the associated channels for the crisis to affect the region are briefly considered. The third chapter outlines the lessons from the previous Asian crisis of 1997-98, through an examination of the post-crisis experience of the five major "crisis-hit" economies. The fourth chapter elaborates upon some of the main macroeconomic transmission mechanisms whereby the crisis is being played out. The fifth chapter focuses on the impact of rising and then

highly volatile international prices of food and fuel in affecting both macroeconomic circumstances and living conditions in developing Asia. In the sixth chapter, some of the initial evidence on the impact of the crisis on employment and other human development indicators in developing Asia in general and certain countries in particular, is presented. The final chapter discusses policy responses, particularly fiscal and monetary responses, to the crisis, and looks forward to consider the prognosis for the medium term, and provides some policy recommendations in different countries that can be considered not only to mitigate the effects of the current crisis, but to move to a more stable, sustainable and equitable growth trajectory that also delivers more inclusive human development. This chapter ends with a brief concluding statement.

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CHAPTER 2

Asia's Integration with the Global Economy

Asia's integration into the world economy over the last decade has been remarkably rapid. For sustaining growth, Asia relies relatively more on exports than any other region in the world. On average, currently Asia's exports to western countries amount to more than one-fourth of GDP and this ratio is higher for developing countries than for developed countries in the region. While the region was earlier home to only a few mercantilist, export-oriented economies like Japan, South Korea, Singapore and Taiwan, more recently every Asian economy has been looking for markets abroad. Some like China proved to be extremely successful in the export of manufactured goods, and others like India in services. However, integration into the world implies more than just exports. Going by the common measure of globalization[2], Asia's two-way trade (exports plus imports), as a proportion of GDP, grew substantially in the last decade. The average level of South Asia's trade integration stagnated at about 22% during the 1980s, but then increased rapidly in the last decade to reach over 35% at present. In East Asia, the rate of integration increased modestly from 34% to 49% over the 1980s, and then accelerated in the 1990s to reach over 80%.

Similarly, Asia's financial integration with the rest of the world and particularly with the US has increased dramatically over the last decade – even more so than trade integration. Developing Asia has been the largest recipient of private capital inflows, and also the largest exporter of capital among developing regions. The liberalisation of rules regarding the presence and operation of foreign firms, including financial firms like banks, insurance companies, hedge funds and private equity firms, has been associated with large increases in gross capital inflows in many economies of the region, which were often far in excess of the amounts needed to finance current account deficits. In fact, some countries with current account surpluses were also recipients of large capital inflows, the most striking example being China. At the same time, both private and public capital outflows became more evident, through activities of domestic companies, sovereign wealth funds and central banks parking their foreign exchange reserves in safe havens. More Asian money is now invested in the western countries than at any point in history. Emerging Asia held the equivalent of 28% of GDP in US Portfolio Securities (both debt and equities) in 2006 compared to 10% in 1994 (see Table 5). In consequence, the ratio of total external transactions (gross current account flows plus gross capital flows) to GDP has increased sharply. For example, it more than doubled in India, from 46.8% in 1997-98 to 117.4% in 2007-08 (Chhibber and Palanivel, 2009).

The period 2003-07 witnessed an explosive growth of cross-border flows of portfolio capital, with a few developing countries attracting an increasing share. Rising investor interest in emerging markets in the 1990s reflected pull factors like faster

2. An overall indicator of integration is the extent of international trade in the domestic economy as measured by the share of exports and imports in GDP and in the global economy as measured by the share of a country's exports and imports in global exports and imports.

growth, relatively stable macroeconomic environments and moves towards economic liberalization. These coincided with the emergence of "push" factors, such as a drop in US interest rates and a slowdown in US industrial production.

The Asian corporate sector's access to external funding has markedly increased in the last five years. This has been associated with increasing shares of investment in GDP in South Asia especially India, while in other parts of the region such as East and Southeast Asia investment rates were generally dwarfed by domestic savings rates. More open capital accounts have led to cross-border movements in both directions. In the Indian case, the macroeconomic outcomes have been complex: the investment ratio increased by 11 percentage points during 2003-08, while the savings rate rose by 9 percentage points. So foreign capital inflows were associated with higher investment, especially in the private sector, but the increase in investment was not as much as would have been expected. India received gross capital inflows amounting to over 9% of GDP in 2007/08 (although net capital flows were much smaller) as against a current account deficit in the balance of payments of just 1.5% of GDP, suggesting that growing financial integration and associated capital inflows did not lead directly to equivalent increases in investment but rather were "saved" in the form of accretions to foreign exchange reserves (Chhibber and Palanivel, 2009).

Intra-regional exports now account for more than 51% of total Asian exports against 9.2% in 1990 and trade among emerging Asia now account for more than 40% of its total trade against 9.8% in 1990.

Given strong trade and financial integration, it is natural that growth in Asian countries has been highly correlated with the US growth cycle over the last decade. The correlation is relatively strong for Malaysia, Philippines and Thailand. The average correlation of growth rates of 14 Asian economies with the US economy increased from 0.1% during 1990-96 to 0.4% during 2000-07. IMF (April 2008) estimated that a decline in the US growth of one percentage point would lead to a 0.6 percentage point drop in Asia's GDP.

South-South trade has been playing a more significant role in the recent past[3]. More than half of the Asia's trade is directed towards developing countries, and especially to intra-regional Asian trade, which increased significantly in the past decade. Intra-regional exports now account for more than 51% of total Asian exports against 9.2% in 1990 and trade among emerging Asia now account for more than 40% of its total trade against 9.8% in 1990 (IMF, 2007), but it is dominantly in the form of intermediate and semi-processed goods, since most of it occurs within vertically integrated regional supply chains before shipment to western countries. In other words, although intra-regional trade is booming, reflecting the specialization of many of the region's economies as part of increasingly sophisticated production chains, the final demand for a large part of the region's exports still derived largely from western economies. While the story in some countries like India appears to be different, even for India the increase in manufacturing exports has been largely to other Asian countries, especially China, while the market for services exports is dominated by the US and EU.

As long as the world economy was booming, global integration was generally seen as providing opportunities: new and growing markets for exports of both goods and services; more foreign direct investment to create new production facilities and allow countries to develop export platforms; accessing international finance through both external commercial

3. In aggregate South–South trade, industrial products dominate with 73% exports market share. The most traded sector is electrical machinery and equipment (including electronics), whose share rose from 18% to 22% in the last decade. Similarly, the share of mineral products (including fuels) trade increased from 12% to 22%. On other hand, the share of textiles and clothing decreased substantially from 13% to 7%. The share of agricultural products in South-South trade also declined from 10% to 6%.

borrowing and portfolio investments; allowing developing countries to benefit from the remittances and skill development that occur through the process of cross-border migration for work. However, the global crisis that originated in the US financial and housing sectors but spread rapidly to other sectors as well as to other economic regions of the world, very rapidly generated significant changes in both the context and the projections for the near future in terms of all these expectations. According to the WTO, world exports are expected to decline by as much as 12-15 % in the current year and remain low in 2010 as well. The US is unlikely to be the engine of world growth through its import demand for the next few years. Financial "deglobalisation" was rapid in terms of the quick reversal of private foreign capital flows to developing countries, particularly commercial bank lending. While private portfolio capital flows to developing Asia have revived in recent months, they are still well below their levels in 2007 and are likely to remain volatile and unstable in the near future. International labour migration has surprisingly not been as much affected as one might have expected, largely because of the lags that operate in such migration and the lower impact of the crisis on women migrant workers who are dominantly in care and domestic service sectors. Remittance flows have remained quite firm despite all the predictions that they would decline. In fact this may well be the surprising aspect of the global financial crisis: capital flows are volatile but labour flows remain more stable.

3 CHAPTER

3 CHAPTER

Lessons from the Recent Past: The Experience of Countries after Economic Crises

While the current crisis is substantially different from earlier financial/economic crises, in as much as it originated in the United States and other developed industrial economies and has spread quite rapidly to involve all the regions of the world, it is not the first time that the region has been hit by financial and economic turmoil. The financial crisis of 1997-98 in East and Southeast Asia (which most severely affected the five countries of Thailand, Indonesia, South Korea, Malaysia and the Philippines) was the most recent reminder within the continent, of the dangers associated with a world dominated by fluid finance. It still serves as an instructive reminder of the ways in which certain factors can create greater financial fragility and vulnerability to crisis, as well as of how post-crisis responses can shape the subsequent growth and development trajectory.

The crisis spawned a large variety of theories on its origins and extent. Of course there was the structural problem of the fallacy of composition in export markets, which made the region's excessive focus on exports as the engine of growth more difficult as competing developing country exporters (such as China) entered the scene. This was a more significant problem than the policy of maintaining fixed exchange rates, which has also been blamed for the crisis, since real exchange rates may have appreciated even more with large capital inflows if nominal rates were flexible. The existence of "crony capitalism" and opaque financial systems have also been cited as causes of the crisis, although these were always more controversial as explanations and have been rendered much less convincing after the global outbreak of the crisis in 2008. It is now widely accepted that the most crucial proximate factor for the crisis was capital account liberalisation – in terms of allowing inflows of capital that enabled short-term borrowing for long-term projects and breaking the link between the ability to access foreign exchange and the need to earn it. The capital inflows into the region that increased as a result of the capital account liberalisation and investor bullishness about export growth caused appreciation of the real exchange rate (which would have happened irrespective of the exchange rate pegs that many economies in the region maintained with respect to the US dollar). This shifted incentives within the economy from tradables to non-tradables, and caused current account deficits to occur as exports effectively became more expensive and imports cheaper. As a result, the capital inflows were associated with current account deficits and deceleration of exports that laid the seed for the eventual reversal of investor confidence.

The specific role of financial liberalisation was further underlined by the fact that other economies in the region that also experienced export slowdown in 1996 and 1997, but had not liberalised finance and the capital account to the same extent (such as Taiwan and Vietnam) did not experience the financial crisis. Mobile capital allowed for faster and more extreme appreciation of exchange rates and also more rapid reversals of capital flows in the crisis hit economies than in other less financially exposed economies of the region.

The crisis of 1997-98 brought home the fact that financial liberalisation can result in crises even in so-called 'miracle economies', whose pace and pattern of GDP growth were significantly higher than the rest of the world. The subsequent experience showed that currency and financial crises have devastating effects on the real economy. Even when crises are essentially financial in origin and in their unfolding, their effects unfortunately do not remain confined to the realm of finance. The ensuing liquidity crunch and wave of bankruptcies result in severe deflation, with attendant consequences for employment and the standard of living. The post-crisis adoption of pro-cyclical IMF stabilisation programmes can worsen the situation by adding public policy-driven downturn to a situation of asset deflation thereby exacerbating the collapse of output and employment. Thereafter, governments become so sensitive to the possibility of future crises that they adopt very restrictive macroeconomic policies and restrain public expenditure even in crucial social sectors. In the immediate post-crisis context, asset price deflation and devaluation pave the way for foreign capital inflows that finance a transfer of ownership of assets from domestic to foreign investors. Finally, when the post-crisis strategy is also associated with continued financial deregulation and lowered emphasis on credit for small borrowers, it can reduce financial inclusion even while it increases financial fragility (Ghosh and Chandrasekhar 2009).

The subsequent experience showed that currency and financial crises have devastating effects on the real economy.

The initial adjustment to the crisis varied significantly across countries, with an acceleration of liberalization in some (South Korea and Thailand) to greater intervention in others (Malaysia). The immediate response tended to be significantly affected by the extent of IMF intervention; indeed, the IMF has been strongly criticised (Stiglitz 2004) for its role in the Asian crisis because it responded in ways that may have intensified the crisis. In situations of asset deflation and associated collapse in economic activity in the crisis-hit countries, it imposed further deflationary pressure by demanding tight monetary policy and high interest rates (in order to reduce the capital outflows) and reductions in public expenditure (to generate more fiscal surpluses or reduce fiscal deficits). As a result, Thailand, Indonesia and South Korea experienced exceptionally sharp reductions in economic activity, and the subsequent recovery was essentially facilitated by a combination of devaluation-induced export increases and some fiscal expansion, including what was enabled by the Miyazawa Initiative. By contrast, Malaysia, which did not go to the IMF and also imposed temporary capital controls in order to prevent further capital flight during its fiscal stimulus, also recovered relatively quickly. In the event, while exports recovered quickly, it is also likely that the financial bailouts to domestic companies and banks along with the fiscal stimulus responses that were initiated in 1998 against IMF advice and in the teeth of criticism from the US and some European governments, also played positive roles in generating the recovery.

Over the subsequent decade, all these economies have recovered, albeit in different ways and to different degrees determined by the nature of the policy response in individual countries. But the recovery has not meant a return to "miracle" status. Instead, it has been accompanied by significant acquisition, at deflated prices, of productive assets in these economies by foreign firms. It has involved a substantial restructuring of the financial sector. It has altered the nature of engagement of the world system by these economies. And it has involved a setback to achievements on the human development front. This is because the crisis did not lead to real changes in the export-led strategy of growth or to greater financial regulation that would have reduced financial fragility and enabled more inclusive growth.

Export growth, which was seen as the key to the success of these five economies in the late eighties and the first half of the 1990s, is often cited as the best indication

of the recovery. Pre-crisis export growth in the region was very high, between 10 and 20 % per year in US dollar terms. The deceleration of export growth in 1996 is widely recognised as one of the proximate causes of the crisis. The export recovery occurred within a couple of years: by 2000 all these five countries were showing sharp increases in rates of export growth of more than 10 %, and in Indonesia it was even more than 30 %. Subsequently, however, export growth has been very volatile in all five countries, with a dramatic collapse (associated with absolute declines in US dollar terms) in 2001. This was also the period when world trade values fell. The apparent synchronicity of export behaviour in these five countries, despite rather different domestic economic strategies, suggests that export performance from the late 1990s, and especially after 2000, has been strongly influenced by global developments.

GDP growth also recovered, but in general this involved growth rates that have been slightly lower, and definitely more volatile, than the growth rates of the previous period. But the most startling change was the broad macroeconomic shift in terms of a large divergence between savings and investment rates. The East and Southeast Asian region generally had very high savings rates – between 30 % and 45 % in these five countries. But the period subsequent to the financial crisis saw an increase in these already high rates, especially in the "crisis" countries. However, investment rates (that is the share of investment in GDP) plummeted in all these countries, as the charts below indicate. Thus, in South Korea the savings rate increased from just below 40 % in the three years before the crisis, to more than 42 % in 2003-05. But the investment rate collapsed by almost half over the same period, from 42 % to 21 %. An almost identical pattern is evident for Malaysia, where investment rates halved from 42 % to 21 %, but domestic savings rates increased from an already high 41 % to more than 43 % between the same two years. In the Philippines, over the same years, the savings rate went up from 26 % to 30 %, but the investment rate fell from 24 % to only 16 %. In Indonesia, the savings rate remained unchanged at around 29 % but the investment rate fell from 31 % to 23 % (Chart 1).

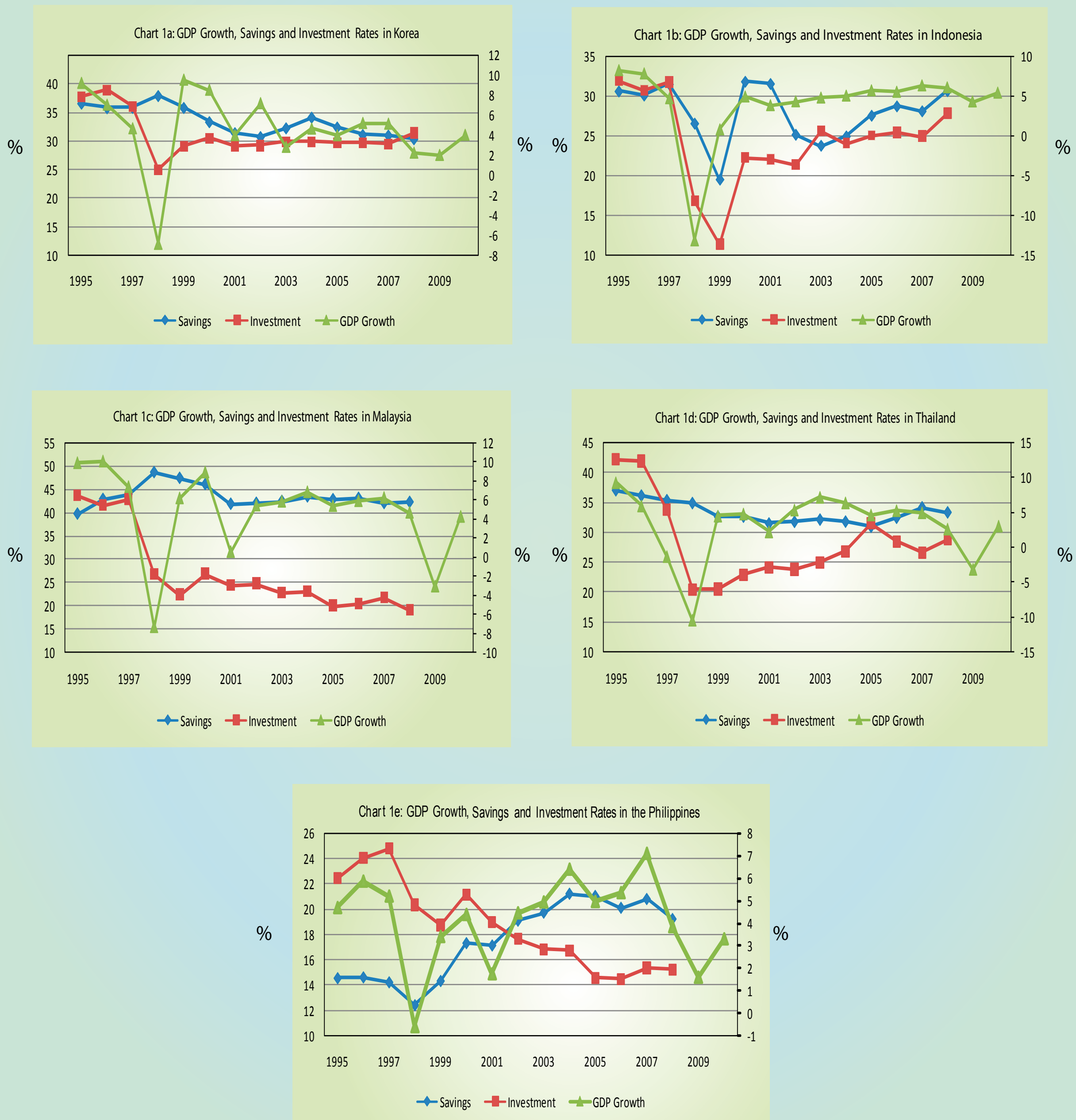
Only Thailand showed a different trajectory: while the investment rate fell sharply after the crisis, it has recovered to some extent in the early years of this decade, although it was still only 28 % in the 2003-05 compared to 41 % in the pre-crisis period. The savings rate also showed a different trend from the other countries: it actually declined somewhat from 35 % average for 1994-96 to 31 % in 2003-05. This different pattern also resulted in slightly more buoyant employment generation in Thailand compared to the other crisis countries. However, even in Thailand, the pre-crisis period was generally characterised by investment rates that were higher than savings rates, whereas the post-crisis period has generally been one in which savings rates have been higher than investment rates.

Therefore in all these five countries, the crisis years of 1997 and 1998 marked a clear break from the earlier trend, when typically domestic investment rates were higher than saving rates, and the balance was met by an inflow of foreign capital. The latter is in fact what one would expect in a developing country, since it is generally supposed that developing countries are characterised by a shortage of investible resources. Therefore economic openness, especially to foreign investment, is designed to allow foreign resources to add to domestic savings in order to generate a higher rate of investment than would be possible using only domestic resources. After the crisis, from 1998 onwards, these five economies actually became more "open" in policy terms, especially with respect to rules regarding foreign investment. Nevertheless, after 1998 all these five countries stopped being net recipients of foreign savings and instead showed the opposite tendency of net resource outflow, as domestic savings

The East and Southeast Asian region generally had very high savings rates – between 30% and 45 % in these five countries. But the period subsequent to the financial crisis saw an increase in these already high rates, especially in the "crisis" countries.

were higher than investment. This meant that there was a process of squeezing out savings from the population as a whole but not investing it within the economy to ensure future growth. Instead, these savings were effectively exported, either through capital outflows or by adding to the external reserves of the central banks, which were typically held in very safe assets abroad (such as US Treasury Bills). This occurred despite the continuing need for more investment within these countries, since the development project is still not complete in these countries and especially in Indonesia, Thailand and the Philippines, where poverty and backwardness remain substantial.

Chart 1: GDP Growth, Savings and Investment Rates in Korea, Indonesia, Malaysia, Thailand and the Philippines



Source: ADB Key Indicators, 2009
Note: Savings and Investment Rates are given in the left axis; GDP growth rate are given in the right axis

This rather paradoxical situation, which is reflective of a broader international tendency whereby developing countries have been providing their resources to the developed world, and in particular to the United States, was described by some as a "savings glut" (Bernanke 2005). Weak or inadequate financial intermediation and undeveloped financial institutions have been blamed for this outcome. But the evidence shows that as financial institutions became more sophisticated, and imitated the North Atlantic model, the divergence between domestic savings and investment actually grew. In any case, it is apparent that the problem in these countries was not the rise in savings so much as the collapse in investment. True, savings rates increased, affected also by crisis-induced shifts in income distribution that reduced workers' consumption and transferred more income to those in a better position to save. But the sharp collapse in investment rates came about because of other factors that then led to the emergence of this "savings surplus". The growing savings surplus was partly – but only partly - the result of the decisions of private agents in these countries, and even these private decisions were strongly affected by official economic policies. For example, stringent monetary conditions, increasing real interest rates and an excess of very rigid and inflexible forms of prudential regulation caused bank credit to be less easily available for investment. A range of other post-crisis measures dampened private investment by directly and indirectly raising the costs of finance and reducing access to it. This obviously reduced investment by large corporate entities, and had even stronger detrimental effects upon small enterprises which found it more difficult to access credit. It is worth noting that the only economy that showed a different pattern in savings and investment – that of Thailand – is one where the government of Thaksin Shinawatra systematically made greater access to institutional credit by small enterprises and farmers a major plank of the post-crisis reconstruction strategy (Pasuk and Baker 2009).

But monetary and financial policies are only one part of the story. A very large role in the reduction of aggregate investment was played by fiscal policies of governments in these countries, who increased their own savings and cut down on fiscal deficits or increased fiscal surpluses across the region. Even though the financial crisis in these countries was essentially brought on by private profligacy in a financially liberalised environment, the aftermath of the financial crises created an environment of excessive caution on the part of governments. The pressure was on governments to keep budget deficits under control by reducing their spending. As a result, governments in these countries did not spend as much as could be easily sustained by the economy, to ensure better conditions for the people or to encourage more sustainable growth and generate more employment.

A very large role in the reduction of aggregate investment was played by fiscal policies of governments in these countries,

So the major cause for this apparent excess of capital, which was then exported to the US and other developed countries, was deflationary policies on the part of these governments, which suppressed domestic consumption and investment. One obvious reason for this was the fear of a repeat of the large and destabilising movements of speculative capital which were such a strong feature of the financial crisis of 1997-98. The idea was to guard against the possibility of such potentially damaging capital flight by building up substantial foreign exchange reserves, even when these may involve large fiscal losses. The other reason was that the economic strategy in these countries was still centred on the obsession with exports as the engine of growth, which combined with deflationary domestic policies that kept levels of aggregate domestic investment lower than savings. This caused an "excess supply" of foreign exchange in the currency market, which would in turn involve an appreciation of currencies, thereby adversely affecting exports.

In a world of liberalised trade where exchange rates cannot be easily controlled, this meant that currencies had to be kept

The role played by Chinese economic expansion in this process must also be acknowledged. This assumed even greater significance after the Asian crisis. While China became part of a diversified export platform in the region that drew in a number of other Asian developing countries, China's vast reservoir of unskilled labour effectively acted as a ceiling on real wages.

at "competitive" levels through market based means. And this in turn meant that foreign currency inflows – whether through more exports or remittances or through capital flows – had to be counteracted by central bank market intervention to purchase foreign currency, to prevent undesired appreciation of the currency. The macroeconomic counterpart – and cause - of the rising foreign exchange reserves held by the central banks of all these countries was therefore the excess of domestic savings over investment, which was actually a huge potential wasted for these economies. Financial liberalisation effectively resulted in the choice of deflationary strategies by governments. This in turn contributed to the excess of domestic savings over investment, thereby threatening currency appreciation. This is what led to the accumulation of unutilised foreign exchange in the form of growing foreign exchange reserves that were invested in "safe" assets abroad such as US Treasury Bills.

The role played by Chinese economic expansion in this process must also be acknowledged. This assumed even greater significance after the Asian crisis. While China became part of a diversified export platform in the region that drew in a number of other Asian developing countries, China's vast reservoir of unskilled labour effectively acted as a ceiling on real wages. As a result, real wages were held back in China and as well as in other Asian economies that were either competing with China for export market share or were part of the relocation in production process in collaboration with China. As wages were held back inequality rose, consumption did not increase commensurately with income, and savings increased significantly and rapidly. More than any other factor the large surplus pool of labour in China acted as a brake on real wages despite improvements in productivity, and increased profit shares of income across the region.

Another key lesson was that social impacts can manifest very quickly after the onset of a crisis. This implies that countries need to be prepared for adverse impacts of economic and natural shocks. For example, even in the period of strong GDP growth, the Asian crisis quickly exposed the vulnerability of countries in the social and political fronts (poverty, unemployment and a loss of political stability). This is because most of these countries had deficient or even non-existent social safety nets, exacerbating the crisis' impact. As of 1997, social policies and programmes in Indonesia, Korea and Thailand provided very limited protection for workers. In Indonesia, old age and disability benefits were limited to firms with more than 10 employees. In Thailand, the pension system covered only 10 % of the labour force (Man and En, 2008). Recently some studies summarized key findings and lessons on the social impact of past crises in Asia, Latin America and other regions (World Bank, 2008; Skoufias, 2003, and Lustig, 2000).

Within the space of a year after the initial signs of the Asian Crisis became evident, South Korea experienced a 4.3 percentage point increase in the unemployment rate translating into 1.5 million jobless individuals. The headcount poverty ratio jumped from 3 % in the last quarter of 1997 to 7.5 % in the third quarter of 1998 among households headed by workers in urban areas. In Indonesia 15 % of households reported job loss or employment problems during the financial crisis. In Thailand, the headcount index increased by 1.4 percentage points to 12.7 % of the active labour force between 1996 and 1998, implying that nearly 1 million people had been pushed below the poverty line as a result of the crisis. Similarly, in the wake of the peso crisis in Mexico, the poverty headcount rose from 23.3 % in 1994 to 28.6 % in 1996 and the unemployment rate increased from 3.7 % to 6.3 % over the same period.

Available data indicates that in almost all previous economic crises, poverty rates have increased. It is also clear that in many countries (Indonesia, Korea, Argentina

and Venezuela), poverty rates in the post crisis period remained high compared to pre-crisis period (Chart 2). On the other hand, experiences on inequality seem to be mixed. In Asia, Brazil, and Uruguay, the crisis has not led worsening inequality. But in other countries, it was not the case. These experiences in Asia and Latin America indicate the potential impact of the global financial crisis of 2008 on living standards in the developing world.

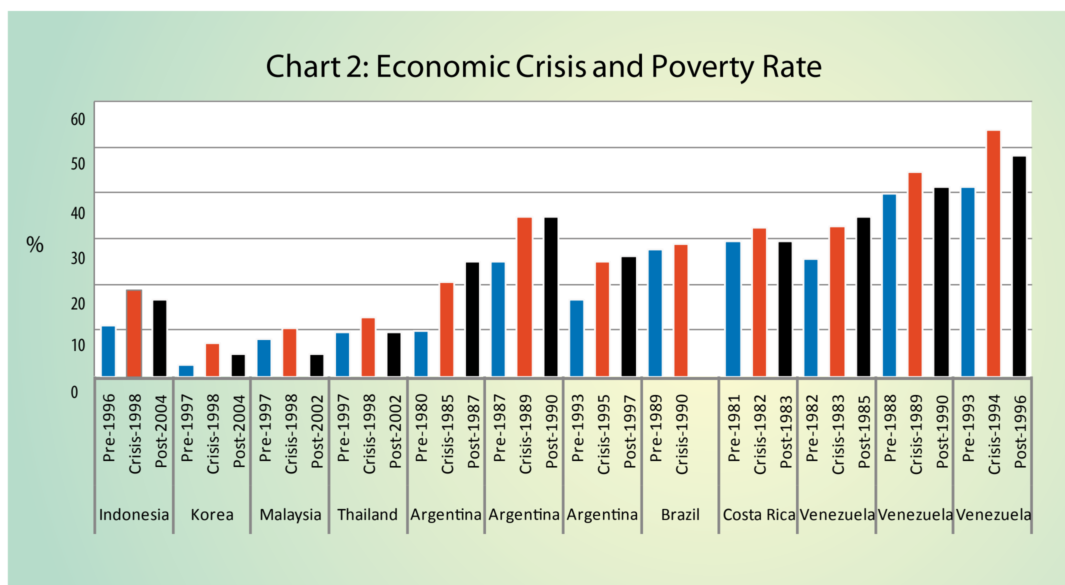


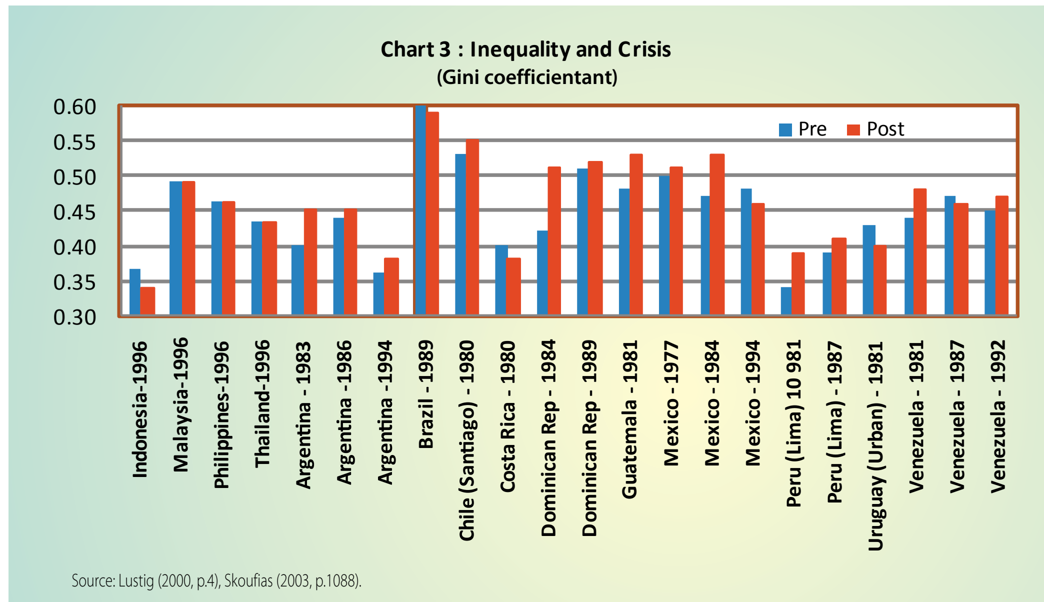
Chart 2: Economic Crisis and Poverty Rate

Source: Lustig (2000, p.4), Skoufias (2003, p.1088).

During the past economic crises, poverty rates remained high in the post crisis period compared to the pre-crisis period

One of the key lessons is that an aggregate shock at the country level will have heterogeneous effects across households, depending on household demographics, education attainments and location. The largest proportionate income losses need not be amongst the poorest initially, since some of whom may be protected by the same factors that have kept them poor, namely geographic isolation and consequently poor linkages with national and global markets. Studies on the poverty impacts of Indonesia's severe economy-wide crisis of 1998 found sharp but geographically uneven increases in poverty (for example, see Ravallion and Lokshin 2007). The proportionate impact on the poverty rate tended to be greater in initially better off and less unequal districts of Indonesia. Another study (Friedman and Levinsohn 2002) of the welfare effects of the same crisis found that most households were impacted, but that it was the urban poor who fared the worst, since the ability of poor rural households to produce food mitigated the worst consequences of high inflation. A comparative study (Bresciani, et al. 2002) on the impact of the financial crisis on agricultural households in Indonesia and Thailand using household-level survey data revealed that although the natures of the shocks in the two countries were similar, the impact on farmers' income was quite different. In Thailand, poor farmers bore the brunt of the crisis, in part because of their greater reliance on the urban economy (through seasonal off-farm work), unlike poor farmers in Indonesia. Urban-rural links are much weaker in Indonesia, and for that reason poorer farmers there were more insulated from the ramifications of the crisis. Farmers in both countries, particularly those specializing in export crops, benefited from the currency devaluation.

During the past economic crises, inequality remained constant in Asia, but seems to have worsened in Latin America



Source: Lustig (2000, p.4), Skoufias (2003, p.1088).

Assessments of the effects of aggregate economic shocks have often presumed that these crises would have negative effects on education and health outcomes, but empirical findings reveal no such simple regularity (Tables 1a and 1b). Some recessions have led to reductions in school enrolment, as in Costa Rica in 1981-82, while others have led to increases, as in the United States during the Great Depression (Ferreira and Schady 2008). Similarly, negative covariate shocks in Zimbabwe associated with the 1982-84 drought led to persistent losses in height-for-age for young children, while infant mortality declined in the US during the Great Depression (Ferreira and Schady 2008). What explains this variation across countries? In predicting the direction of the short term impact of economic crises, economic shocks have income and substitution effects which, in the absence of policy interventions, determine whether schooling and health outcomes would improve or deteriorate. A contraction of GDP has a negative income effect which can lead to lower investments in education and health. In the case of schooling, the substitution effect derives from a decline in child wages due to decreased labour demand during such a contraction. This has the effect of reducing the opportunity cost of schooling, thereby leading to higher school enrolment. In the case of health, the substitution effect arises because the decline in labour demand reduces adult wages which, in turn, frees up parents' time for time-intensive health-promoting activities (collecting clean water, cooking better meals, or taking children to health check-ups). The aggregate effect of a crisis on education and health outcomes cannot therefore be determined ex ante—it is an empirical matter (World Bank, 2008).

Table 1a: Impact of Past Crises on education varies depending upon level of economic development	
Rich countries	Positive impact - United States
Middle-income countries	Ambiguous impact
	Examples of positive impact: Brazil, Mexico, Nicaragua, Peru,
	Examples of negative impact: Costa Rica
Poor countries	Negative impact - Cote d'Ivoire, Indonesia, Malawi,

Source: Ferreira and Schady (2008, p.50).

In practice, recessions in developed countries are generally associated with better health and education outcomes. In the United States, economic downturns have generally decreased infant mortality. In the countries of the former Soviet Union, crisis than in other years (Schady, 2004). But time series household data show that the infant mortality increased by 2.5 percentage points during the crisis.(World Bank, 2008).

Table 1b: Impact of Past Crises on Child Health and Nutrition varies depending upon level of economic development	
Rich countries	Positive impact - United States
Middle-income countries	Ambiguous impact
	Examples of positive impact: Columbia
	Examples of negative impact: Peru , Mexico, Russia
Poor countries	Negative impact - Nicaragua, India, Cote d'Ivoire, Zimbabwe, Ethiopia, Tanzania, Cameroon

Source: Ferreira and Schady (2008, p.50).

research has indicated that declining income was associated with dramatic increases in adult mortality, but there was no obvious change in child health. This pattern implies that the substitution effect dominates the income effect.

However, in the poorest developing countries, both health and education outcomes deteriorate during economic crises, suggesting that the income effect dominates (World Bank, 2008). This pattern is consistent with evidence from Cote d'Ivoire, Ethiopia, Malawi, Tanzania, Zimbabwe and (less clearly) Indonesia, as well as (for health) India. In middle-income countries, health outcomes deteriorate during crises (as found in Mexico, Peru, Nicaragua), while schooling is unaffected or improves (as found in Brazil, Mexico, Nicaragua, and Peru). For example, in Peru, a middle-income country with high levels of school enrolment, the deep economic crisis in the late 1980s could have decreased schooling outcomes because public expenditures and household incomes fell. However, these reductions seem to have been offset by the lower opportunity cost of attending school. Hence, although public education spending fell by almost 50 %, children were more likely to be enrolled and less likely to be working during the

In Indonesia the 1997 financial crisis decreased enrolment rates among children aged 8-13 years and increased enrolment rates among children aged 14-19 years, but these changes were small, just one percentage point of enrolment. A study of the relationship between log per-capita GDP and infant mortality using data on births and deaths from Demographic and Health Surveys (DHS) covering 59 countries conducted between 1986 and 2004 (Baird, Friedman, and Schady 2007) found that a 1-% contraction in per-capita GDP was associated with an increase in infant mortality of between 0.18 and 0.44 deaths per thousand children born. This finding means that there were about one million excess deaths during the period 1980-2004 in countries experiencing large economic contractions (World Bank, 2008). In the short run, households might try to smooth consumption by increasing their labour supply and drawing down their savings. But when work opportunities are scarce and families have little or no access to credit, they may have to reduce food intake or pull out children from school.

What is evident is that while financial crises create sharp and painful economic shocks and may alter longer-term economic trajectories, this depends crucially upon the

nature of the policy response. In particular, the extent of which the recovery from the crisis and subsequent growth are associated with more productive employment generation is extremely important. That is why the choice of strategies that are - and will be - adopted to cope with and reverse the current crisis, is so important.

While the insights gained from analysis of previous crises is important, the current crisis is widely considered to be distinctive in several respects. First, the previous crises were mainly confined to particular national or regional economies. None of them affected the global economy in a significant manner. But the current crisis is global, hitting both developed and developing economies, covering all geographical regions. The world economy is likely to contract in 2009, which is unprecedented since the Great Depression in 1929. Second, the current crisis is exerting a much greater impact on global commodity prices, financial markets and economic activity throughout the world than was true of the prior crises. In other words, while most emphasis was initially on the sub-prime market in the United States, the crisis has spread rapidly not only to other countries and regions, but also to other sectors. Third, the current crisis (like Asian crisis in the late 1990s) appears to be more deeply rooted in financial imbalances in the private sector than in the public sector financial problems that characterized the 1980s debt crisis and the Mexican 1994-95 crisis or the Turkish crisis of 2000. Fourth, unlike previous crises, the most distressed financial assets are opaque pools of several layers of securitized loans that may be difficult to unbundle and value. Fifth, the previous crises affected mainly countries with weak macro fundamentals. But the current crisis is affecting even countries with strong macro fundamentals (such as those with high growth and low inflation, substantial foreign exchange reserves, low fiscal and current account deficits, low public debt stock, robust corporate balance sheets and relatively healthy banking sector). While such countries would earlier have been considered to be relatively immune, they have also faced tremendous pressure on their currencies and equity markets as well as sudden turnaround in their growth prospects. Sixth, the recovery may not be straightforward, because developing countries will need a domestic demand-led recovery as they cannot rely on export-led recovery. Finally, prior to the current financial crisis, the world economy was already affected by rapid oil price rises and a more general bull market of rising prices for primary commodities. One early effect was a substantial increase in food prices that had a particular impact on poorer communities across the world. While prices came down in the midst of the financial crisis, they are on the increase once again, with associated implications.

Prior to the current financial crisis, the world economy was already affected by rapid oil price rises and a more general bull market of rising prices for primary commodities.

There have been repeated comparisons of the current crisis with the Great Depression in 1929, which also started in the US. Indeed, the current financial crisis shares some of the features of the Great Depression of 1929. Both are global crises –not limited to a specific region or country. The epicentre of both crises was located in a developed economy –in one of the largest economies and one most closely connected to the rest of the world economy – with grave consequences for the real economy, also at the global level. However, certain important differences, such as the greater financial integration of different developed and developing regions of the world economy and the differing policy responses, suggest that the past is at best an imperfect guide to the present.

Global
Bank
Crisis
SINGAPORE
EURO
TEN HONG
INDONESIA

4
CHAPTER

The Current Crisis: Macroeconomic Transmission Mechanisms

This time the Asia-Pacific region is better prepared for financial and economic crises than it was a decade ago during Asian financial crisis, having improved current account balances and built up a protective shield of foreign exchange reserves. Notwithstanding this resilience, there have still been negative domestic impacts, in some cases quite severe. These have been unequally distributed, with certain sectors and segments of the population much worse affected than others.

4.1. The broad trends

The recent synchronicity of growth rates across the different regions of the world has been so marked that it is unprecedented in the long history of booms and slumps in global capitalism. Every single developing region has been affected, and some developing regions / countries have experienced even worse economic impacts than the developed world/US economy in which the crisis started. However, unlike many other regions of the world, on the whole, in developing Asia, the crisis did not cause an overall decline in GDP but a deceleration of growth and the subsequent "recovery" is also currently seen to be faster and more pronounced in this region. Asia is cyclically tied to the developed world but its long term growth rates are nevertheless much higher and can become de-linked from the growth of the developed world with appropriate policies. In any case there is strong evidence that Asia is converging rapidly (Chart 4).

The global financial crisis affected developing Asia mainly through two channels. The first and more immediate impact was through financial contagion and spill over effects on stock and currency markets. The second, which operated through real economic variables, was the effect that recession in the

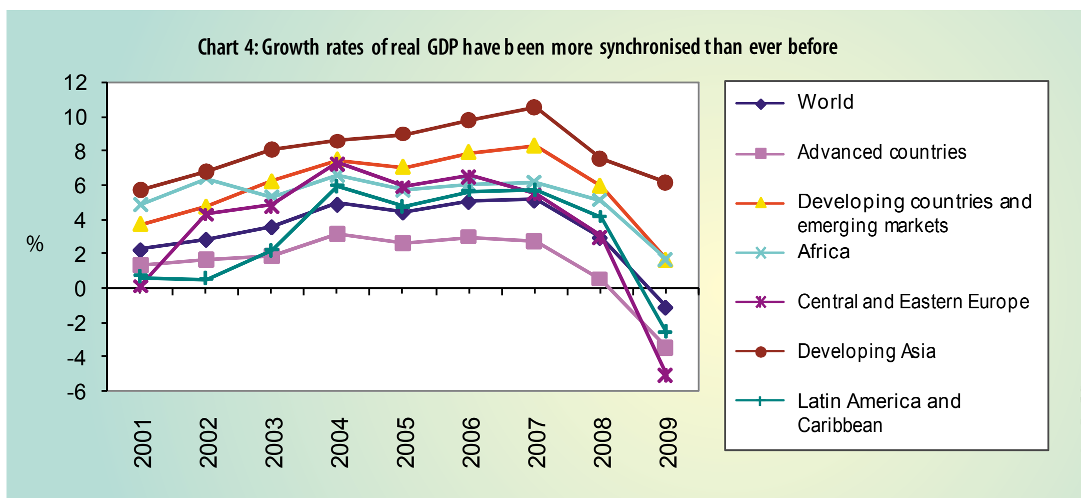


Chart 4: Growth rates of real GDP have been more synchronised than ever before

Source: IMF, World Economic Outlook-October 2009

World exports have been falling since late 2008, and are currently estimated to decline by anywhere between 11 % and 15 % in 2009.

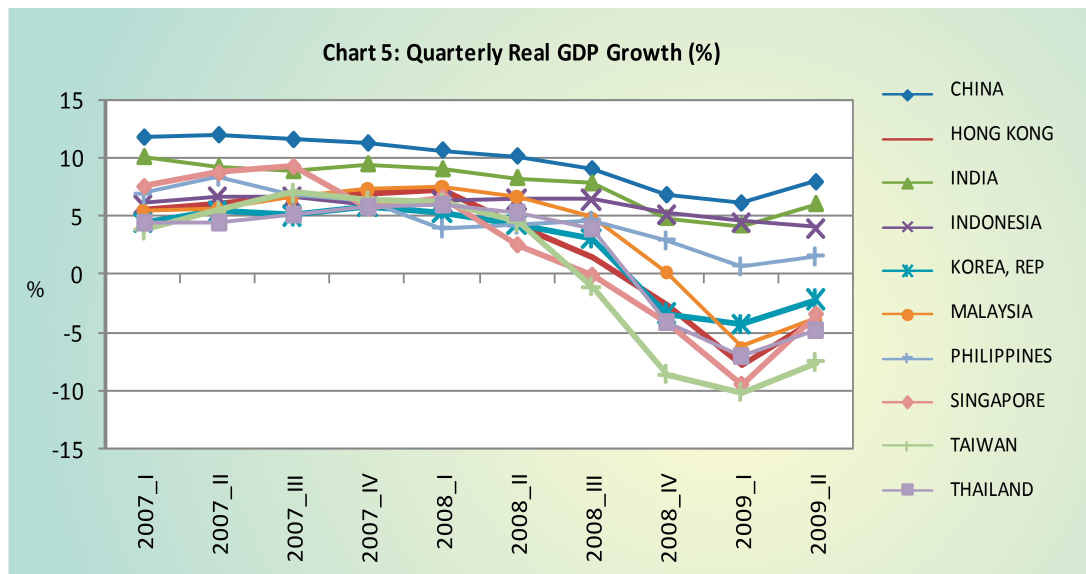
developed economies had on growth and development prospects in Asia, through secondary transmission channels such as falling quantities and values of exports, deteriorating terms of trade, reduced remittances of migrant workers, reduced tourism receipts, slower growth or reversal of foreign investment, and reduced availability of ODA. These then operated through negative multiplier effects within countries to cause a downward spiral in the economy.

World exports have been falling since late 2008, and are currently estimated to decline by anywhere between 11 % (IMF) and 15 % (WTO) in 2009. Capital flows initially showed very sharp reversals, not necessarily reflecting any economic "fundamentals", but simply the impact of "flight to safety" of finance capital flowing back to the US and Europe. This was then reflected in the movement of external reserves held by developing Asia, as well as exchange rates. For much of the past decade, developing Asia added to its external reserves, not just China whose reserve build-up was based on export surpluses, but even countries like India, Indonesia, Vietnam and Bangladesh that relied on either capital inflows or remittances for the additional foreign exchange. This pattern changed from mid-2008, with foreign exchange reserves showing extreme volatility, falling from June 2008 to around April 2009, and once again rising since then in most countries.

The quarterly data on GDP growth rates brings out the synchronised nature of the collapse in major Asian economies. Even in countries where growth remained positive throughout, the deceleration in growth rates was evident from early 2008, and by the last quarter of 2008 real output growth turned negative for at least six of 10 Asian economies for which data are available (Chart 5). Several case studies in this volume note how the growth slowdown had effectively started before the global crisis broke, because the particular growth strategies in some of these economies – whether reliant on export-led growth or on credit-financed domestic consumer booms – were running out of steam. However, the real downslide occurred after the crisis had clearly hit export markets. It should be noted that nonetheless, growth rates in some large exporters, such as China, remained relatively high.

It may be noted that although GDP growth rates in South Asian countries have moderated, the declines have been much less severe than in South-East Asia or East Asia. In part, South Asia has been shielded by its relatively limited integration

Quartely Real GDP Growth (%) turned negative in 6 of 10 Asian Economies by Q4, 2008



Source: Economic Intelligence Unit Country Database October 2009

into the global economy. The story is also similar if one compares growth rates in Asian low-income countries with that of Asian emerging economies. It may also be noted though output remains well-below potential, in the emerging economies of South-Asia and East Asia, they have staged a V-shaped turnaround from a sharp decline in their economic activities. The three large developing economies namely China, India and Indonesia experienced smaller downturns and are now returning to their long-term high growth path.

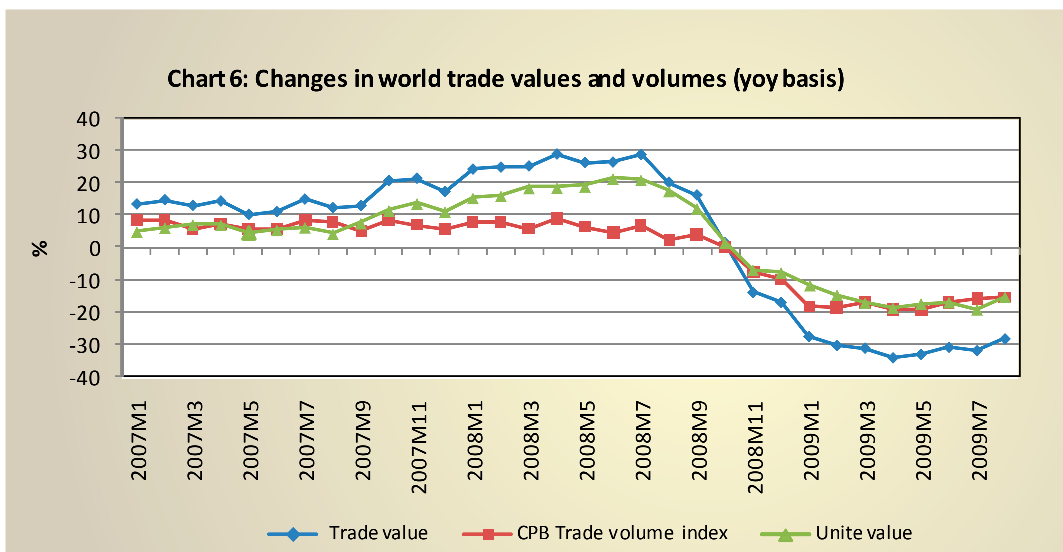
4.2. Merchandise exports

The developing economies of Asia were significantly hit by the slowdown in world exports. Global trade values decelerated from the middle of 2008 and started falling from late 2008. This reflected declines in both unit values and volumes, as competitive pressures forced exporting countries to bring down prices in an effort to retain or expand market share. As a result, trade values fell even faster then would be indicated by the volume index alone. Only very recently has this been associated with any recovery in export volumes in the aggregate – and in developing Asia the recent increase in export volumes from the floor of early 2009 has been strongly related to sharp declines in unit values of exports Chart 6)[4].

The monthly data on exports clearly brings out how exports slumped quite sharply in the aftermath of the financial crisis, turning negative across the region, especially in Southeast Asia (Chart 7). Imports also fell, usually following exports by a few months. The decline in imports reflected the decline in international oil prices and the moderation in domestic economic activity, as well as the growing import intensity of much of the export production. Recent data indicate a bottoming out in exports and imports, and some countries have seen a marked improvement in export performance in the last few months. Since imports have collapsed more dramatically than exports, trade balance has improved in many countries (Chart 8).

Exports in low income countries of Asia seem to be held up somewhat better than those of emerging economies in the developed markets because of product mix. In the G-3 markets, demand for textiles and garments and low-end manufacturing appears to have been less affected during this downturn, with some garment exporters (e.g., Bangladesh) even managing

Countries brought down export prices in an effort to retain the market, but this has not worked.

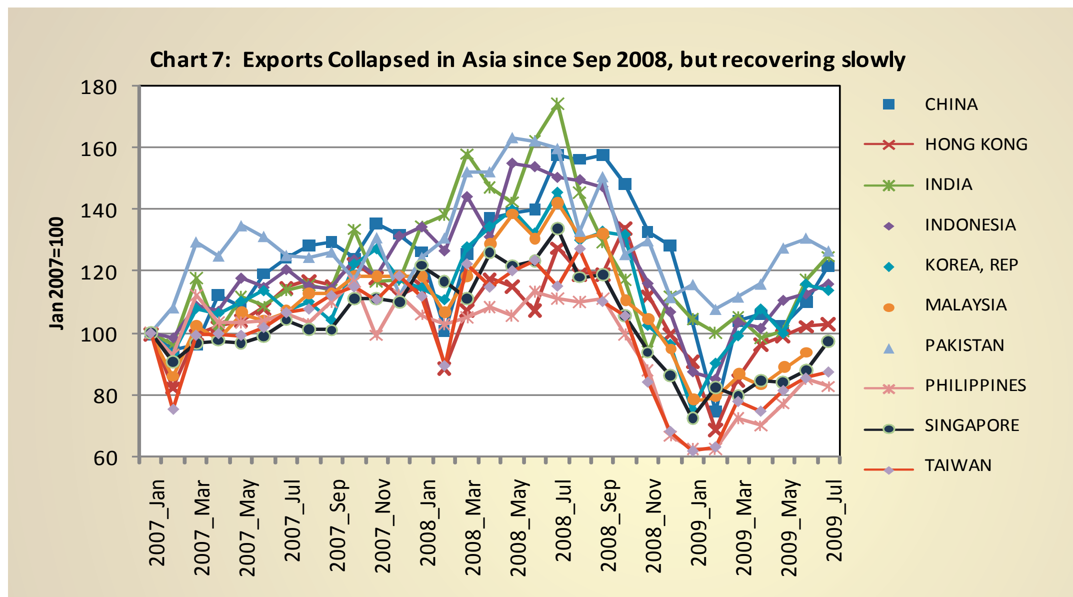


Source: World Trade Monitor: August 2009CPB Netherlands Bureau for Economic Policy Analysis, Oct 2009.

4. Rapid diversification of exports away from traditional products and toward assembly/component specialization within global industries have tended to weaken the link between the real exchange rate and export performance. World demand and production capacity have increased in importance in determining exports. Particularly in the long run, production capacity tends to play an important role in determining performance of exports (see Juthathip Jongwanich 2007).

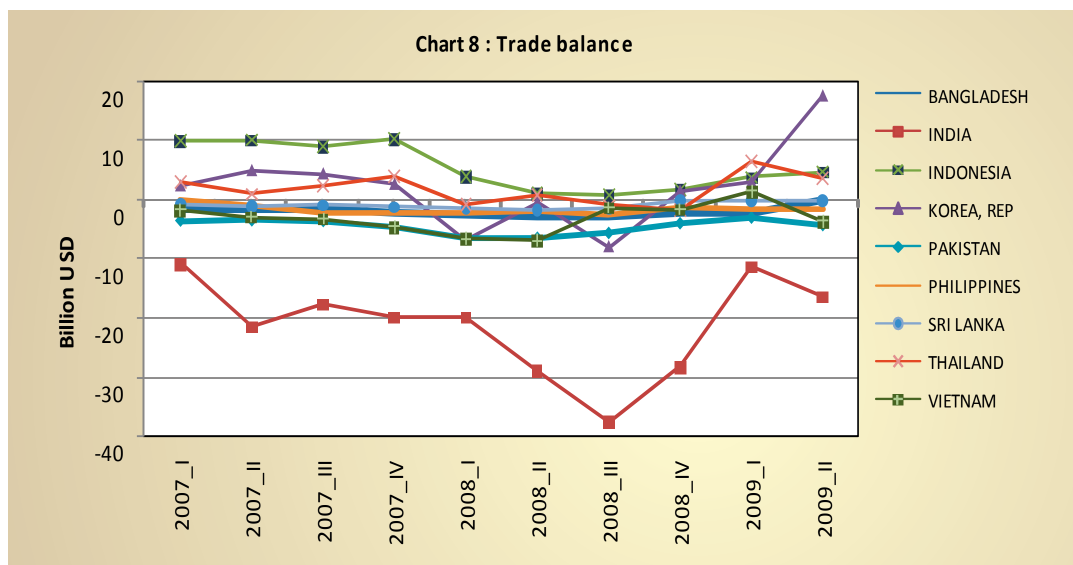
to expand their market share. On the other hand, demand for medium- and high-end manufacturing products appears to have been affected severely; consequently exports in emerging economies have suffered.

Despite the slump in exports, current account surpluses have remained quite high as proportion of GDP in both East Asia and Southeast Asia, although there are a few countries with moderately large current account deficits in these sub regions. By contrast, South Asia, which was already running current account deficits before the global crisis, saw these worsen during 2008 and the current year is also expected to generate deficit on this account (Chart 9). Since capital flows initially reversed as a consequence of the crisis, this reduced the space for domestic countercyclical measures in countries facing foreign exchange constraints.



Source: Economic Intelligence Unit Country Database-October 2009

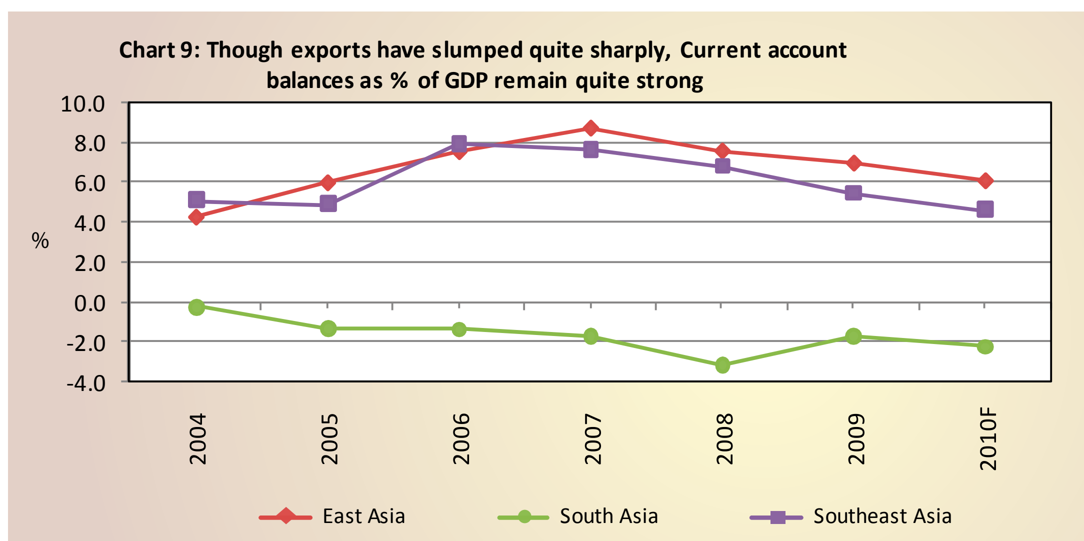
Imports have slumped quite sharply than exports; consequently the trade balance is actually increasing in Asia



Source: Economic Intelligence Unit Country Database - October 2009

This rapid effect of the slowdown in developed country markets on the exports from developing Asia is scarcely surprising, given the high degree of dependence upon these markets in most of the major exporting countries of the region (Table 2).

However, it is also evident from Table 3, that recent trade patterns have reduced this share of China in the exports of all the three sub-regions of developing Asia increased very sharply between 2000 and 2007 while the share of the main developed countries (US, EU and Japan) fell. Also, trade within developing Asia among countries other than China has also increased. This has led to the view that export-led growth can continue to be the strategy for this region,



Source: ADB Asian Development Outlook 2009

Table 2: Asian Export Exposure to Developed Countries (as % of GDP)

	Exposure to the U.S.				Exposure to the EU-15			
	Direct		Total[1]		Direct		Total[1]	
	1994	2006	1994	2006	1994	2006	1994	2006
China	5.6	9.6	7.6	12.0	3.9	7.7	6.0	12.0
India	1.7	2.4	2.0	3.1	2.6	3.1	3.3	4.5
Korea	4.9	5.1	6.1	8.7	2.7	5.0	3.9	8.2
Singapore	23.9	17.3	31.9	31.0	17.0	20.1	25.5	36.0
Indonesia	3.3	3.5	4.5	5.6	3.4	3.7	4.8	6.4
Malaysia	18.0	22.7	25.0	32.0	11.4	13.8	18.3	25.0
Philippines	8.8	8.0	9.8	12.0	3.7	7.1	5.0	13.0
Thailand	7.0	10.5	8.9	15.0	5.2	8.7	7.5	15.0
Vietnam	1.4	15.2	2.8	19.0	6.6	15.0	8.6	21.0
Emerging Asia[2]	9.2	10.8	12.0	16.0	6.8	9.7	9.8	16.0

Sources: IMF Regional Economic Outlook April 2008
1. Includes indirect exposure through exports of intermediate and capital goods via third countries.
2. Arithmetic non-weighted average

to generate external demand for other countries in Asia because of this shift in the direction of trade.

This view has been supported by recent economic indicators from China, which have been so robust that they have inspired the argument that even if the Chinese economy is still too small to act as an engine of growth for the world, it

and this is largely because an increasing share of exports (more than 60 % in 2007) consists of processing exports, in a process which uses imported raw material and intermediates from other countries to transform into final goods for export. What is noteworthy is that while Chinese exports declined because of the slump in global trade, Chinese imports fell even faster. As a result, the trade balance is actually

Table 3: Direction of exports (% of total exports)

To	Other Asian countries		China		Japan		United States		European Union		Others	
From	2000	2007	2000	2007	2000	2007	2000	2007	2000	2007	2000	2007
Central Asia	9.2	10.0	4.1	10.1	0.5	0.7	1.7	2.2	28.1	32.5	56.4	44.5
East Asia	25.9	27.3	11.7	14.1	11.4	7.2	21.8	14.4	15.2	13.5	13.9	23.4
of which China	32.9	33.1	-	-	16.3	7.4	20.4	16.4	16.1	14.6	14.3	28.6
South Asia	17.3	20.1	1.6	7.3	3.6	2.1	24.2	15.0	26.3	19.0	26.9	36.5
Southeast Asia	37.4	41.2	3.7	8.9	12.6	9.4	18.2	12.2	14.4	11.1	13.7	17.2
The Pacific	11.2	10.5	5.2	6.4	10.3	6.7	5.3	2.8	11.1	6.7	56.9	67.0

Source: ADB Asian Development Outlook 2009

To begin with, China's exports and imports have tended to move together, and this is largely because an increasing share of exports (more than 60 % in 2007) consists of processing exports, in a process which uses imported raw material and intermediates from other countries to transform into final goods for export.

can play that role for the Asian developing region. China, its argued, can also help other major commodity producers. For example Australia seems to have emerged from its recession quickly because of China. Certainly it appears that the fairly large fiscal stimulus of the Chinese government, along with other measures to ease interest rates and increase credit access, have worked in terms of increasing both domestic demand and economic activity in China. Thus, while exports have slumped in response to the global trend, domestic demand and retail sales have picked up. As a result, preliminary data for the second quarter of 2009 suggest that GDP is growing by nearly 9 % at an annualised rate, and industrial production in June was 10.7 % higher than it was in the same month of the previous year.

However, there are several reasons to consider such a view to be excessively optimistic. To begin with, China's exports and imports have tended to move together,

increasing, to reach the projected level of around $370 billion in 2009. So the impetus coming from Chinese demand for imports is currently declining faster than China's own exports.

The other reason to be cautious regarding the potential of China to become an alternative growth engine for the region as a whole is because most of the trade, both imports and exports, that is occurring within developing Asia (including China) as a whole, is part of a vertically disintegrated production process that is producing final goods for export to developed countries. In terms of final demand, as opposed to material to be used for further processing, only around one-fifth (22 %) of the exports of East and Southeast Asia are directed within the region, and the remaining four-fifths is for export to the rest of the world. Nearly 60 % of exports are intended for final demand to the Big Three: the US, EU and Japan (Chart 10). So the slump in imports in

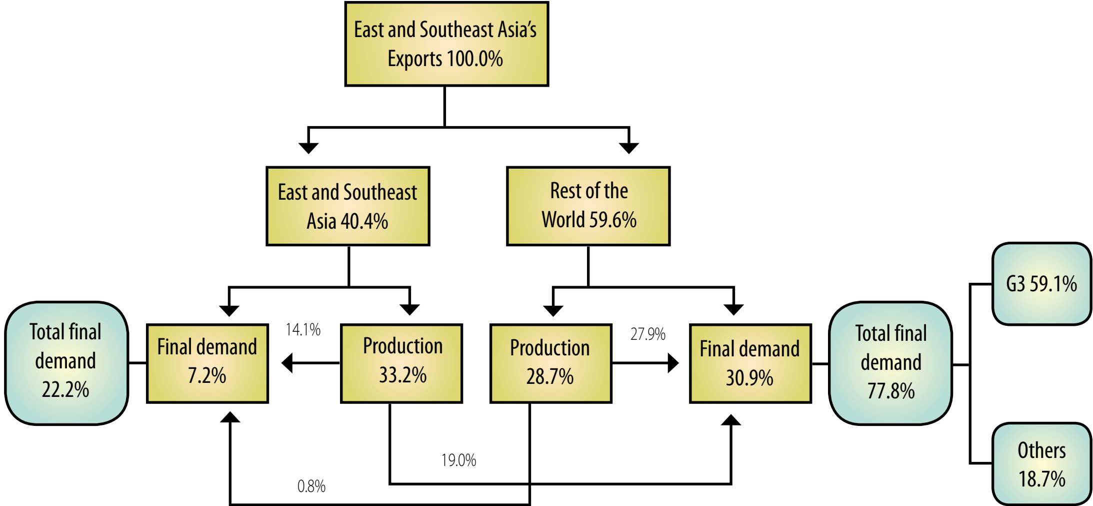
these major markets, which is likely to continue for some time, will definitely affect the region. Economic growth in China that is based on the expansion of domestic demand is therefore likely to be less import-intensive and therefore pull in less exported commodities from the other developing countries of the region per unit of output. This partly explains why the rate of reduction in imports has been even faster than that of exports in value terms.

4.3. Services exports

Services exports have emerged as an important source of foreign exchange and employment generation for many countries in developing Asia. Contrary to the general perception of India as the most important service exporter from developing Asia, China is the largest exporter of commercial services, and also has been experiencing very rapid rate of growth especially in transport services. To some extent that is explained by the rapid growth of foreign trade, which would naturally have required more transport services. But the fast increase in other commercial services exports by China, at around 22 % per annum in the period 2000-2007, is worth noting. However, unlike China, which has a net deficit in commercial services, India has a surplus in this category.

Service exports are vulnerable to the global crisis because of the significant reliance on the developed country markets. Where data are available (such as for Hong Kong and South Korea) they suggest that the United States and the European Union accounted for around 40 % of total services exports in 2007. In India, it is known that around 60 % of software exports (the fastest growing category of services exports in India) are destined for the US market alone. A significant proportion of that has been to the banking and financial services industry. The impact of the crisis on this sector, and the subsequent (and related) protectionist attempts to limit off shoring of services by Northern

Chart 10: Trade linkages in emerging Asia



Note: Emerging Asia comprises People's of China; Hong Kong, China; Indonesia; Republic of Korea; Malaysia; Philippines; Singapore; Taipei, China; and Thailand
Source: Author's calculation based on the Global Trade Analysis Project (GTAP) database (version 7)
Source: Soyoung Kim, Jong-Wha Lee, and Cyn-Young Park (2009)

Source: Soyoung Kim, Jong-Wha Lee, and Cyn-Young Park (2009)

One specific element of travel services that has direct employment effects is the tourism industry. The past decade witnessed a substantial increase in international tourism in developing Asia, including intra-Asian tourism that reflects the growing prosperity of Asian middle classes as well as some easing of restraints on cross-border travel within the region.

companies, are therefore likely to have a clear negative impact on such exports. Nonetheless, thus far services exports that are not linked to merchandise trade have held up through the crisis. Thus far, largely because service exports from Asia still form a very small part of global services trade, and offshoring of services remains an important cost-cutting strategy of firms in developed countries as they deal with the global crisis.

One specific element of travel services that has direct employment effects is the tourism industry. The past decade witnessed a substantial increase in international tourism in developing Asia, including intra-Asian tourism that reflects the growing prosperity of Asian middle classes as well as some easing of restraints on cross-border travel within the region. However, the crisis acted swiftly and sharply to affect tourism in several Asian countries. Both tourist arrivals and tourism receipts (in US dollar terms) decelerated sharply in 2008 compared to 2007 for most countries, and even turned negative from very rapid earlier growth in the case of China. Initial evidence from the case studies suggests that the downward trend has continued into 2009. In addition to the economic effects of the crisis, concerns about the spread of the AH1N1 virus and security concerns in some countries in the region are also likely to affect tourist arrivals.

Though the crisis acted swiftly to reduce tourism receipts in many countries of the region, overall the impact on tourism receipts seem to be modest compared to other trade and financial flows. This may be because the crisis seems to have changed the geographical pattern of tourist arrivals. For example, since the onset of the global financial crisis, Cambodia has received fewer tourists from South Korea and Japan as well as other high income countries, but more from Vietnam and China. This has implications for tourism revenues, since per capita spending of tourists from these countries tends to be lower. So, while tourist arrivals show only about 2.3 % decline, there has been a shift away from high-end tourists to budget travellers, resulting in declining revenues. It has been found that luxury hotels have been facing lower occupancy rates than three star and budget hotels. This is significant because the tourism sector accounts for more than 13 % of Cambodia's GDP.

Some countries with a higher proportion of tourists from Asia-Pacific countries (such as Indonesia, where more than half came from the Asia Pacific region, with Japan, Australia, China, Malaysia and South

Table 4: Rate of growth of tourist arrivals and tourism receipts (% per year)

	Tourist arrivals		Tourism receipts	
	2007	2008	2007	2008
Cambodia	18.5	5.5		
China	-	-	23.48	-2.57
Hong Kong	11.56	4.75	16.40	13.12
India	14.26	5.62	24.26	9.49
Indonesia	20.19	14.5	13.02	13.24
Malaysia	19.52	5.15	27.02	7.58
Singapore	0.00	0.00	13.93	4.80
Sri Lanka	-11.72	-11.24	-6.31	-16.88
Taiwan	5.58	3.47	1.52	13.85
Thailand	4.56	-	13.57	-
Vietnam	18.02	0.15	-	-

Korea among the top five markets) have been relatively less adversely affected by the downturn. However, in Vietnam the opposite tendency was evident: while all tourist arrivals reduced by 22 % in the first five months of 2009, tourists from China and South Korea decreased by 38 % and 22 % respectively, while the number from US fell by only 1.2 % and those from Canada actually increased by 4.2 %.

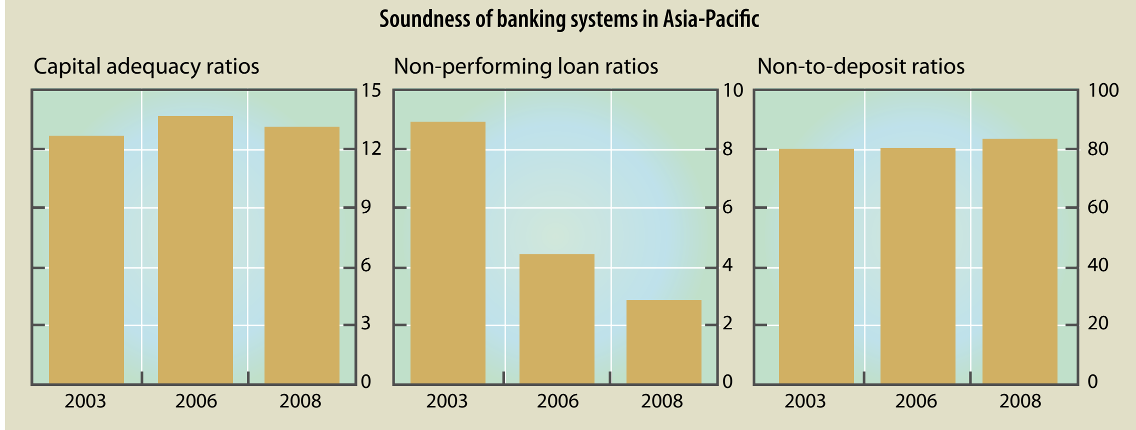
4.4 The impact of capital outflows and financial turbulence

Unlike the Asian crisis of 1997-98, and unlike the evolution of the current crisis in many other parts of the world, the banking system in most of emerging Asia has thus far not been particularly badly affected. There are several reasons for this: the relatively limited exposure of Asian banks to sub-prime financial products in the US (with some exceptions such as in Malaysia and Singapore); the greater emphasis on supervision and regulation in the banking systems of the Asian crisis-affected economies; the fact that several countries (China, India, Vietnam) still have a significant part of the banking system under public ownership and control; and the relatively low leverage of corporates in Asia compared to other regions (with some exceptions of particular companies in certain countries). Capital adequacy ratios have been very healthy on average, and non-performing loans have formed a low and declining proportion of total loans. However, there is substantial variation across countries in this regard, with non-performing loan ratios being much higher in Thailand, Malaysia and the Philippines.

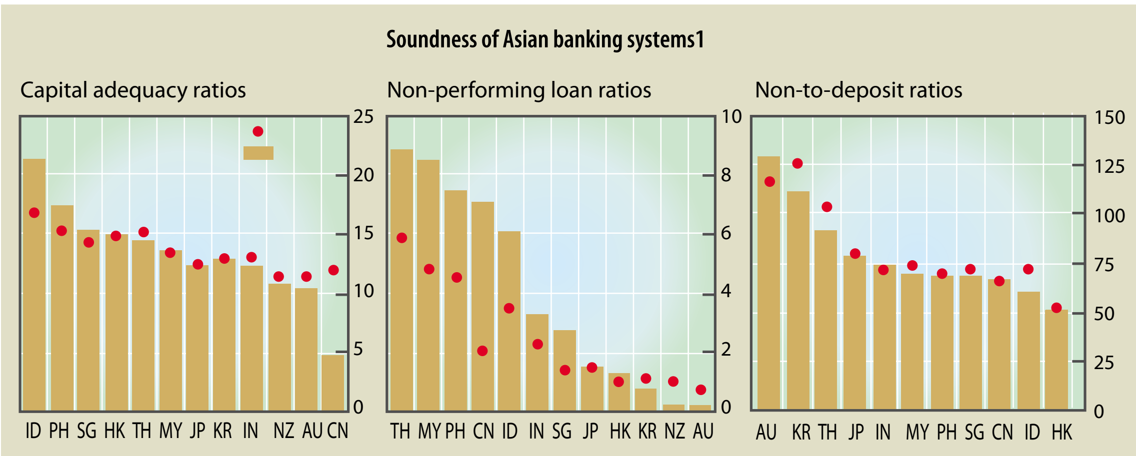
To some extent the very soundness of Asian banking systems reflects the conservatism that resulted from the experience of the Asian crisis, which in turn was likely to have been associated with insufficient extension of credit especially to small borrowers. In the event, despite prior caution, the global crisis did lead to a deceleration in credit growth and in some cases even a decline, as the banking reversals in the North created greater risk-aversion among bankers within the region. This tendency was more marked in those countries with a higher presence of transnational banks. To some extent, this was mitigated by the middle of 2009 by active government intervention designed to reduce interest rates and revive credit creation in most Asian countries. Even so, reduced bank lending, not only to construction and large industry, but in particular to small producers, who dominate in employment generation, is likely to remain a major impediment to comprehensive economic recovery in the regions without active mitigation efforts.

Despite the greater domestic stability of banking and financial systems in developing Asia, the region was nonetheless affected, at least temporarily, by a sudden reversal of

Chart 11: Soundness of Banking Systems in Asia-Pacific



Source: Bank of International Settlements (2009)



Source: Bank of International Settlements (2009)

On average, banking systems in Asia improved their prudential indicators after the 1997 financial crisis. But there is substantial variation across countries in terms of soundness of banking systems

capital inflows, with attendant effects on reserves, currency values and liquidity. The damaging effects of this continue to be felt in some countries, but in most countries of the region capital outflows had stopped and inflows turned positive by March 2009. This is at least partly due to the international perception of fundamentally better growth prospects in the Asian region compared to other segments of the world economy. As a result, stock markets which had earlier collapsed have rebounded, even if they have not reached levels achieved during the earlier peak, and currencies which depreciated sharply are now strengthening.

It should be noted that financial liberalisation, by itself, does not offer any guarantee of capital inflows either in normal times or in times of irrational exuberance. Capital inflows do not necessarily rise sharply immediately after liberalisation, nor do all countries attract inflows once they liberalise. Thus, during the period of the global capital surge beginning in 2004, a few developing countries in Asia accounted for an overwhelming share of capital flows to emerging markets in the region. Table 6 shows that the 7 top emerging market recipients of capital inflows received between 85 and 95 % of the flows into emerging Asia. The recent revival of capital flows into developing Asia has similarly been focussed on a relatively

Table 5: Financial exposure to US markets has increased over the period

	U.S. Holdings of Asian Portfolio Securities		Asian Holdings of U.S. Portfolio Securities	
	Dec-94	Dec-06	Dec-94	Jun-06
China	0.3	2.2	2.3	28.8
India	…	5.5	…	2.5
Korea	1.4	12.4	1.2	14.2
Singapore	8.6	35.8	42.9	129.2
Indonesia	1.2	3.7	1.0	3.4
Malaysia	11.5	9.2	6.8	10.5
Philippines	3.1	7.9	3.3	7.9
Thailand	3.1	5.7	4.4	8.2
Vietnam	…	0.1	…	4.1
Asia	5.1	13.3	8.3	25.9
Emerging Asia1	4.6	13.1	10.0	28.2

Sources: IMF Regional Economic Outlook April 2008
1. Arithmetic non-weighted average

small number of countries, including China and India. Partly because of the crisis, such inflows have not been "used", but instead largely been transformed into increasing reserves, which increased by $510 billion in emerging Asia between March and September 2009 (IMF Asian Regional Economic Outlook October 2009).

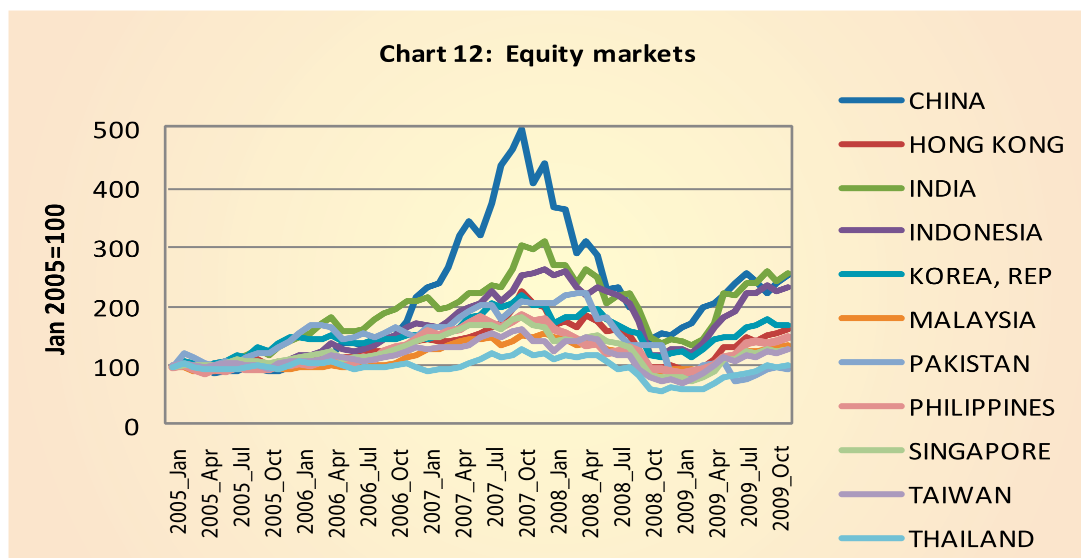
Table 6: Share of "Top Seven" in Asian emerging market external financing

	2004	2005	2006	2007	2008	Q1 08	Q2 08	Q3 08	Q4 08
China	16.8	20.5	22.6	25.2	15.8	19.5	15.1	15.9	7.5
Hong Kong	12.7	10.6	11.6	7.9	8.4	4.3	8.9	14.1	6.4
India	8.7	11.4	13.3	19.6	20.2	25.7	14.8	18.3	22.6
Indonesia	2.7	2.7	3.8	2.7	7.5	6.6	10.9	3.5	9.4
Korea	20.4	25.2	17.4	20.1	18.6	19.4	25.7	10.1	16.0
Singapore	7.8	7.7	8.9	6.6	11.1	9.8	11.7	13.9	7.6
Taiwan	17.4	10.1	10.0	8.2	9.8	10.5	5.6	11.2	15.2
Total	86.6	88.1	87.6	90.4	91.3	95.7	92.8	86.9	84.8

Source: Bank of International settlements

Emerging markets in Asia were the recipients of a substantial amount of portfolio capital flows especially in 2007 and early 2008, when bullish sentiments about the region contrasted sharply with evidence of fragility in Northern equity markets. As a result, there were very sharp increases in stock market indices especially in some countries, such as China and India. Since such stock markets tend to be both narrow and shallow (since the shares of relatively few firms are traded in the stock exchange and of those listed firms the proportion of actively traded stocks is relatively small), the activities of foreign portfolio investors can have dramatic effects on the price indices. This substantially explains the volatility (boom followed by dramatic decline followed by

Equity Markets intially collapsed, but recently show strong recovery



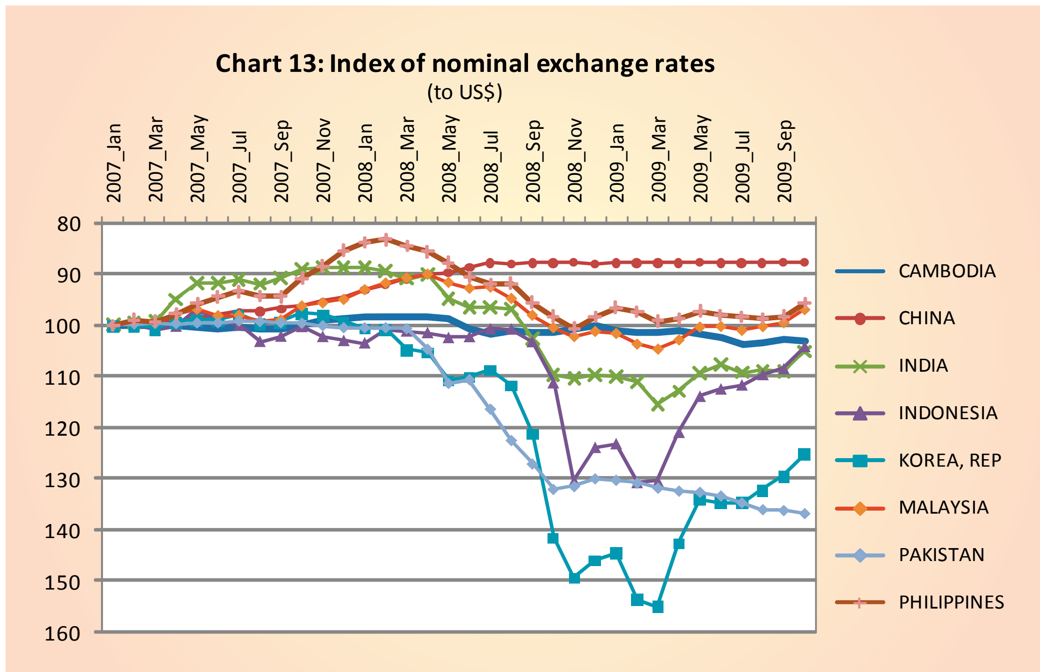
rebound in recent months) experienced by stock markets in several emerging markets of Asia (Chart 12). While stock market valuations and their movements do not really reflect the health of the real economy, they can nonetheless affect the real economy through their impact on particular variables such as investor confidence, ability of firms to access finance for new investment and most of all, the exchange rate. While this can contribute to domestic boom (typically in non-tradeable activities) it can also affect the exchange rate, as discussed below.

Given this experience, this may be the time for many Asian countries to re-examine their capital account liberalisation policies and develop strategies to contain excessive volatility in both inflows and outflows.

4.5 Exchange rate changes

The sharp depreciation of exchange rates across developing Asia (with the exception of China) was a singular feature of the crisis. This was not the result of conscious and competitive (beggar-thy-neighbour) devaluations that were associated with earlier global depressions. Nor was the extent of currency depreciation always justified by the extent of trade or current account deficits of the countries concerned. Rather, in most cases the movement of exchange rates was an involuntary process reflecting the movements of highly mobile capital.

Nominal exchange rates in Asia on average depreciated by 12% in January 2009 compared to the peak of July-August 2007. Real exchange rates showed less movement, amounting to 5 % appreciation followed by almost equivalent depreciation. These movements may not appear to be large, but in a global context of low and falling tariffs and very low margins in exports, such changes can make a lot of difference to export markets. The subsequent recovery in nominal exchange rates in most countries (with the marked exception of China which has maintained an implicit peg of the Yuan to the US dollar) still involved an overall depreciation compared to pre-crisis rates (Chart 13). The recovery has been associated with less movement in real exchange rates because inflation has generally been positive though still low in developing Asia compared with deflation in the advanced countries, and because the US dollar has also been depreciating.



Source: Economic Intelligence Unit Country Database, downloaded October 200

Asian currencies (except Chinese Yuan) depreciated substantially in 2008, but recovered/ stabilised in 2009.

This reflects the fact that movements of exchange rates – which are no longer affected by policy other than in a few exceptional countries – cannot be explained by either trade patterns or "fundamentals" such as the inherent strength or future prospects of an economy. They are much more likely to be affected by what could broadly be called "political economy" factors, and perceptions of current and future power, that determine the capital flows that actually decide their values. At the trough of the crisis, countries in developing Asia faced a double shock because of depreciating exchange rates even as their export volumes collapse. The subsequent increase in nominal rates has reflected global investor perceptions of better growth prospects in this region compared to other parts of the global economy.

Such movements in exchange rates do more than affect the macroeconomic indicators and the state of investor expectations. They also have direct and indirect effects upon conditions of human development, in particular by affecting the prices of essential commodities especially when they are largely or marginally imported. Indeed, this rapid decline in nominal – and often real – exchange rates has created inflationary pressures, particularly in food and energy markets, in several Asian developing countries despite the other tendencies making for real economic stagnation. The possibility of stagflation in some countries is therefore now more real in several vulnerable economies, especially those that face fiscal and balance of payments constraints on appropriate policy responses.

4.6 Remittances

In addition to merchandise exports, one major source of foreign exchange for many Asian developing countries has been remittances sent by migrant workers back to their homes. Short term migration increased rapidly in the past two decades, and most of it has been within the Asian continent, reflecting the significance of labour-scarce oil-exporting countries within the region as well as the differential

levels of development that different Asian countries have reached. Table 7 provides an indication of the major flows of migrant labour within developing Asia.

This has provided crucial foreign exchange and been a major contributor to balance of payments stability to many of the smaller economies in the region, and even for large countries like India and China has played a significant role in domestic consumption. The ongoing global economic crisis has been widely predicted (World Bank 2008, 2009; ILO 2008) to change all that, as international migration and associated remittances generally perceived to be among the first casualties. At one level this is obvious: it is only to be expected that when economic activity slows or contracts in destination countries, migrant workers are the first to be laid off and sent home. Since a lot of recent economic migration has been explicitly short-term in terms of meeting specific labour shortages in the host economies, this is even more likely.

The ongoing global economic crisis has been widely predicted to change all that, as international migration and associated remittances generally perceived to be among the first casualties.

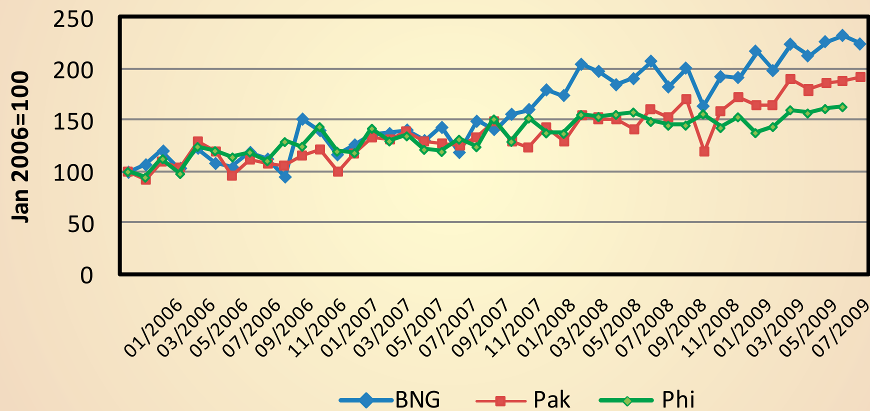
Initial reports supported this expectation, with evidence of decelerating remittances from countries that relied strongly on them, such as in Pakistan and Philippines. But as the crisis unfolds, it is also becoming clear that the patterns of migration and remittances may be more complex than was previously imagined. Though growth of remittance flows moderated in some countries, overall flows remained resilient (Chart 14). In fact, in several countries (such as Bangladesh, India, Pakistan, Philippines, Nepal and Sri Lanka) remittance inflows have actually increased rather than declined so far. To some extent this too can be expected, because even if the crisis leads to large-scale retrenchment of migrant workers who are forced to come home, they would obviously return with their accumulated savings. In such a case, there could even be a (temporary) spike in remittances rather than a continuous or sharp decline because of the crisis. Eventually, as the adverse conditions for overseas employment further aggravate, this would then lead to decline in remittance inflows. Intra-Asian migration may be affected by migration policies instituted by some governments in the wake of the crisis, such as moves by Republic of Korea, Malaysia and Thailand to restrict work permits for migrants.

However, it is not so inevitable that there would eventually be a sharp decline in migration and remittances. One important aspect that is frequently ignored in the discussions on migration is the gender dimension. International migration for work is highly gendered, especially in Asia, with male migrants going in dominantly for employment in manufacturing and construction sectors, while women migrants are concentrated in the service sectors, such as the care economy broadly defined (including activities such as nursing and domestic work) and "entertainment The different nature of work also affects remittance flows. In the first place, female migrants are far more likely to send remittances home, and typically send a greater proportion of their earnings back. Also, male migrant workers find that incomes are much more linked to the business cycle

Table 7: Migration Status of Asian Countries

Labour Sending	Bangladesh, Cambodia, China, Indonesia, Lao PDR, Myanmar, Nepal, Philippines, Sri Lanka, Vietnam
Labour Sending and Receiving	India, Malaysia, Pakistan, Thailand
Labour Receiving	Brunei Darussalam, Hong Kong SAR, Japan, Middle East, Republic of Korea, Singapore, Taiwan China

Source: Wickramasekara 2002 (with additions by Ghosh 2004)



Source: CEIC database

in the host economy, so their employment and wages tend to vary with output behaviour. Thus job losses in the North during this crisis have been concentrated in construction, financial services and manufacturing, all dominated by male workers. By contrast, the care activities dominantly performed by women workers tend to be affected by other variables such as demographic tendencies, institutional arrangements, and the extent to which women work outside the home in the host country. So employment in such activities is often relatively invariant to the business cycle, or at least responds to a lesser extent. Therefore female migrants workers' incomes are more stable over the cycle and do not immediately rise or fall to the same extent. This in turn means that source countries that have a disproportionately higher share of women out-migrants (such as Philippines and Sri Lanka) would tend to experience less adverse impact in terms of downturn of remittances. Indeed, in the Philippines, most recent data indicate that remittance flows are still increasing slightly, at an annual rate of around 2 %. This does not mean that there will be no impact at all, but certainly the adverse effects will be less and will take longer to work through than if the migration had been dominated by male workers.

There are other factors at work as well, which have meant that the negative effects of the crisis on patterns of migration have not been evident as immediately or sharply as expected. For example, one expectation was that the return migration would be dominated by the worst hit workers, who in turn were expected to be the undocumented, irregular or illegal migrants who are mostly in low-wage and low-skilled occupations, and do not qualify for any kind of official support such as welfare benefits or social security from the host country. But once again the evidence thus far belies this expectation.

There are several reasons for this. Such migrants may be unwilling to return home to possibly even more fragile and insecure employment conditions in the home country. Many developing countries have been even worse hit by the financial crisis that originated in the US economy. So the push factors that operated to cause international migration in search of work are as strong as ever. The unwillingness to return in such a context may be even stronger where the undocumented migrants have already developed some local social networks that allow them to survive for a period while they look out for other employment. In the host country,

undocumented migrant workers may even be preferred by employers who see in them a cheaper source of labour than legal migrants or local workers. A context of crisis may well make that preference for cheaper labour even sharper. This may be yet another reason why women migrants may be less badly affected, since women migrants dominate in the undocumented and illegal category.

In any case, one of the basic pull factors still remains significant: the demographic transition in the North that is increasing the share of the older population that requires more care from younger workers, who must therefore come from abroad. So the current crisis may temporarily slow down the ongoing process of international migration for work, but it is unlikely to reverse it.

4.7 The impact on government fiscal positions

Developing Asia was until recently considered to be relatively immune from the global crisis for several reasons: the significant role of China as a regional economic leader and potential growth pole; the cushion provided by the very large external reserves that had been built up over the past six years by Asian central banks; the fact that most Asian governments had been following prudent if not downright conservative fiscal strategies that have focussed on restricting government expenditure rather than raising taxes and consequently have generated very low fiscal deficits or fiscal surpluses.

Despite all this, the crisis has nonetheless operated directly to worsen fiscal balances in most Asian countries, in ways that have been partly elaborated above (Table 8). Declining exports and the associated downturn (or deceleration) in economic activity reduced tax revenues. The need to bailout companies in distress, or provide tax and other incentives meant that government expenditure increased even in the absence of increases in direct public expenditure. Rising and then volatile prices of food and fuel caused public subsidies to rise in countries in which these prices are even partly controlled, because domestic prices typically did not go up as much as global prices and even the subsequent decline in such prices were such as to keep international prices higher than domestic prices[5]. These factors implied worsening fiscal balances even before any attempt could be made to increase government spending as part of a fiscal stimulus package to counter the crisis or enhancing social assistance measures to protect vulnerable groups.

It is worth noting at this point that the concept of fiscal space, which is increasingly used as a guide to future fiscal stance, should not be seen as determined by the existing levels of fiscal deficits or public debt. This is because fiscal deficits will be inflationary only if (a) they involve an aggregate excess of expenditure over income, which in turn implies that the initial spending will not generate at least equivalent output through a multiplier process; and (b) the economy cannot afford to import to make up any supply shortfalls that could hinder the multiplier process, which in turn implies that the country cannot access foreign exchange either through capital inflows or drawing down of reserves. Only in situations in which both of these conditions are met can it be argued that the government does not have the fiscal space to provide a countercyclical stimulus. It is obvious that the existing level of the fiscal deficit tells us very little about either of these conditions, except insofar as large deficits and high initial public debt stock with rising interest payments at interest rates which exceed the economy's growth rate suggest that the limits to non-inflationary spending may be closer.

5. It is also true that as food and fuel prices fell there was some fiscal relief as the budgets for 2009 had assumed much higher food and fuel prices in some countries such as Bangladesh and in India.

Table 8: Most Asian countries now follow countercyclical fiscal policy

	2004	2005	2006	2007	2008	2009*	2010*
South Asia							
Bangladesh	-4.2	-4.4	-3.9	-3.1	-6.1	-6.4	-6.0
India	-3.9	-4.1	-3.5	-2.7	-6.1	-7.8	-6.8
Pakistan	-2.0	-3.2	-4.2	-4.5	-7.3	-4.3	-5.0
Sri Lanka	-7.4	-7.0	-7.0	-6.9	-6.6	-8.6	-7.8
Southeast Asia							
Cambodia	-4.1	-2.5	-2.7	-2.9	-2.9	-5.5	-5.2
Indonesia	-1.1	-0.2	-1.0	-1.2	-1.9	-2.8	-1.8
Laos	-3.4	-4.4	-3.8	-2.8	-2.8	-3.3	-3.1
Malaysia	-4.1	-3.6	-3.3	-3.2	-4.8	-8.0	-8.3
Myanmar	-1.9	-2.2	-2.6	-3.0	-3.5	-4.5	-4.8
Philippines	-3.9	-2.7	-1.0	-0.2	-0.9	-3.1	-2.5
Singapore	-1.1	-0.3	0.5	3.3	1.5	-4.1	-4.9
Thailand	0.0	0.3	1.2	-2.3	-1.1	-5.6	-3.5
Vietnam	-3.3	-4.1	-2.9	-7.0	-5.1	-9.0	-8.1
East Asia							
China	-1.3	-1.2	-0.8	0.6	-0.4	-4.1	-3.2
Hong Kong China	1.7	1.0	4.0	7.7	-0.3	-3.9	-3.7
South Korea	0.7	0.6	0.4	3.5	1.2	-5.0	-3.8
Taiwan China	-2.4	-1.6	-0.7	-0.4	-1.3	-5.2	
Pacific							
Papua New Guinea	1.5	0.0	3.2	2.5	-2.3	-2.7	-1.2

Source: Economic Intelligence Unit; * Projected

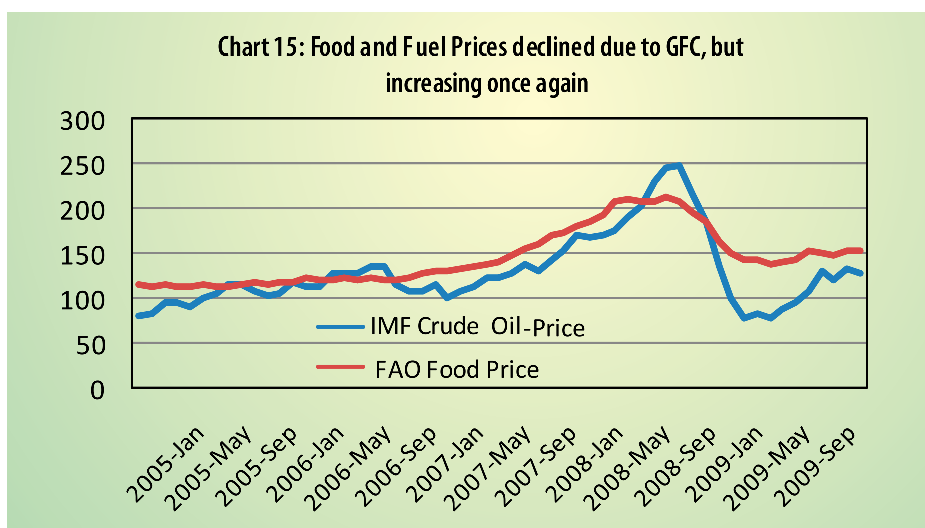
The evidence is clear that the crisis has involved growing fiscal deficits, or a change from surplus to deficit, in many Asian countries. Table 8 provides evidence on this. Fiscal deficits have increased in all but a very few countries. The exceptions (such as Pakistan and Sri Lanka) are countries that have been forced to seek IMF assistance and consequently have faced policy conditionalities that include a lower fiscal deficit even in the face of crisis. However, the change in fiscal stance, in terms of a marked increase in deficit to GDP ratio or a shift from surplus to deficit, has been evident only in relatively few countries, such as China, South Korea, Malaysia, Philippines, Singapore, Cambodia and Vietnam. In other countries of the region, the fiscal response thus far has been relatively muted suggesting either that government feel or are constrained in particular ways because of high levels of existing fiscal deficits or that the need for countercyclical macroeconomic measures is less keenly felt in these countries.

CHAPTER 5

5 CHAPTER

Volatility in International Commodity Prices, especially of Food and Fuel[6]

For nearly a quarter century after the late 1970s, global commodity prices tended to decline relative to the price of other traded goods, although with considerable volatility. However, between 2002 and 2008, this decline was reversed with very substantial increases in price, especially in the world trade prices of oil and certain agricultural commodities. The period since January 2007 has been especially remarkable because of dramatic volatility: very sharp and rapid price hikes followed by almost equally sharp declines all in a relatively short period. Rising energy prices until Sep 2008 caused balance of payments difficulties and imported inflation in many developing countries, while the impact of the rise in food prices was even more dramatic, being associated with a global food crisis that became starkly evident by the middle of 2008. Although the decline in oil prices in the aftermath of financial crisis has provided some relief for the oil-importing countries of the region, the sharp exchange rate devaluations that were noted in the previous section have tended to negate some of this. However, the effect of these trends in global food prices has generally been far more adverse for most of developing Asia, because while there was relatively high pass-through of rising prices into domestic food prices for many countries, the subsequent decline in global prices has not been reflected in declining domestic prices of food. It should also be noted that food and fuel prices are still high compared to early 2007. Prices started to rise in recent months, as many countries, particularly Asian countries, are rebounding fast from the depths of the global crisis. Strong world-wide economic recovery could push up commodity prices once again (Chart 15).



Source: IMF & FAO

6. This section draws on Palanivel (2008) and Ghosh (2009, forthcoming).

5.1. Causes of global price volatility for food and fuel

In 2008-09 global production of the major food grains increased by 5.4 % compared to 2006-07, whereas global utilisation increased by only 3.4 %.

This food crisis is not something that can be treated as discrete and separate from the global financial crisis. On the contrary, it has been intimately connected with it, particularly through the impact of financial speculation on world trade prices of food. The excess liquidity in global markets because of the decision of the US Treasury not to try and dampen the financial bubble, as well as the financial deregulation that allowed greater financial investor activity in commodity futures markets, constitute a large part of the story that led first to high fuel prices and then very high food prices as the shift to crop based fuels in the face of rising fuel prices occurred. So the fuel, food, and ultimately the financial crisis are all interlinked. This is not to deny the undoubted role of other real economy factors in affecting the global food situation. While demand-supply imbalances have been touted as reasons, this is largely unjustified given that there has been hardly any change in the world demand for food in the past three years. In 2008-09 global production of the major food grains increased by 5.4 % compared to 2006-07, whereas global utilisation increased by only 3.4 %. End of season stocks actually increased by 8.7 % (FAO 2009).

In particular, the claim that food grain prices have soared because of more demand from China and India as their GDP increases, is completely invalid, since both aggregate and per capita consumption of grain have actually fallen in both countries. The quantity of grains consumed has been declining rapidly with a rise in real per capita income in both China and India. The per capita annual consumption of cereals declined from 131 kg to 76 kg in urban China, and from 262 kg to 206 kg in rural China between 1990 and 2006. Similarly, the per capita annual consumption of cereals declined from 145 kg to 124 kg in urban India, and from 189 kg to 156 kg in rural India between 1988 and 2002. The reasons for this apparently paradoxical process have been hotly debated in both countries, and have ranged from changing dietary choices (Hanumantha Rao) to worsening income distribution and reduced access of the mass of population to affordable food (Utsa Patnaik 2006). In any case, China and India have had relatively little effect on international trade prices through their direct imports or exports. Both countries have been net exporters of cereals in the last decade. China has been a net importer of food grains in only one season - 2004-05. Similarly, India has been a net importer of cereals only once, in the 2006-07 season. Therefore the impact of China and India on world cereal prices would at best have been minimal and indirect. Similarly, although both China and India witnessed a significant increase in their imports of oilseed, meals and edible oils in the last decade, there is no evidence that there has been a sudden increase in the imports from this source to indicate that they have contributed to the recent price hike for oilseeds, meals or oils (FAO 2008).

Supply factors have been – and are likely to continue to be – more significant. These include the short-run effects of diversion of both acreage and food crop output for biofuel production, as well as more medium term factors such as rising costs of inputs, falling productivity because of soil depletion, inadequate public investment in agricultural research and extension, and the impact of climate changes that have affected harvests in different ways.

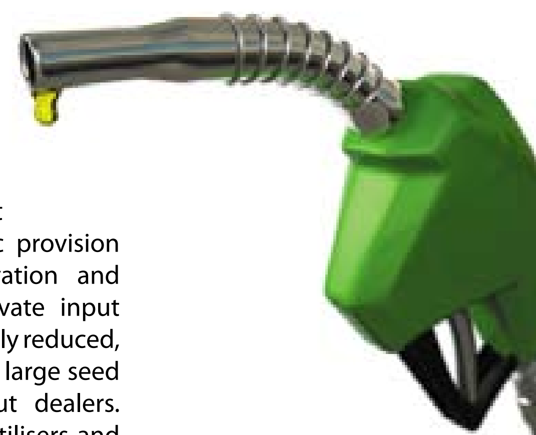
Two policy factors affecting global food supply require special note. The first is the biofuel factor: the impact of both oil prices and government policies in the US, Europe, Brazil and elsewhere that have promoted biofuels as an alternative to petroleum. This has led to significant shifts in acreage to the cultivation of crops that can produce biofuels, and diversion of such output to fuel production. For example, in 2007 the US diverted more than 30 % of its maize production, Brazil used half of its sugar cane production and the European Union

used the greater part of its vegetable oil seeds production as well as imported vegetable oils, to make biofuel. In addition to diverting corn output into non-food use, this has also reduced acreage for other crops and has naturally reduced the available land for producing food.

The IMF estimated that the increased demand for biofuels accounted for 70 % of the increase in maize prices and 40 % of the increase in soybean prices (Lipsky 2008). Collins (2008) estimated that the increased demand for biofuels accounted for 60 % of the increase in maize prices for the period 2006-08. Rosegrant et al. (2008) calculated the increase demand bio fuel accounted for 30 % of the increase in real cereals prices, 39 % of the increase in real maize prices, 22% of the increase in real wheat prices and 21% of the real rice prices for the period 2000-07. These increases in nominal prices of these commodities are much higher. The USDA also attributed much of the increase in farm prices of maize and soybeans to biofuel production (Glauber 2008). Estimates differ widely due to differences in time periods, prices, and food items considered. Despite all the differences, these studies unambiguously reveal that increased demand for biofuel production is indeed a major driver of soaring global food prices.

The irony is that biofuels do not even fulfil the promises of ensuring energy security or retarding the pace of global warming. Ethanol production is extremely energy-intensive, so it does not really lead to any energy saving. Even in the most 'efficient' producer of ethanol – Brazil - where sugar cane rather than corn is used to produce ethanol, it has been argued that the push for such production has led to large-scale deforestation of the Amazon, thereby further intensifying the problems of global warming. Indeed, recent scientific research suggests that the diversion of land to growing biofuel crops can produce an enormous 'CO2 debt' from the use of machinery and fertilisers, the release of carbon from the soil and the loss of CO2 sequestration by trees and other plants that have been cleared for cultivation (Beddington 2008). Yet, as long as government subsidies remain in the US and elsewhere, and world oil prices remain high, biofuel production is likely to continue to be encouraged despite the evident problems. And it will continue to have negative effects on global food production and availability.

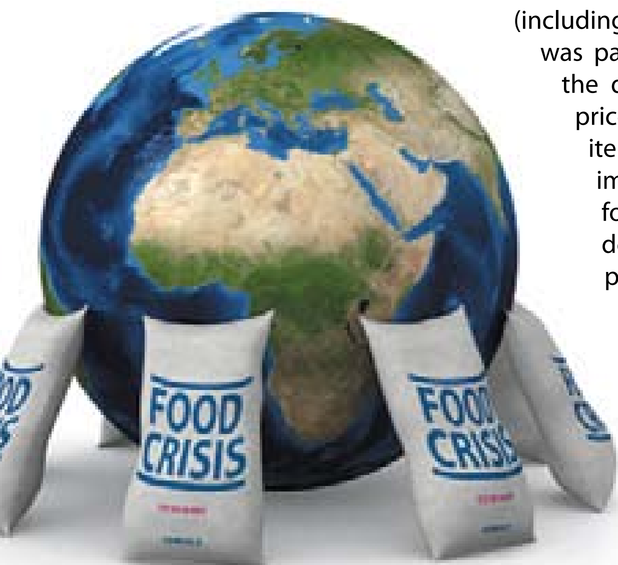
The second factor is the policy neglect of agriculture over the past two decades, the impact of which is finally being felt. The prolonged agrarian crisis in many parts of the developing world has been largely a policy-determined crisis. Inappropriate policies have several aspects, but they all result from the basic neo-liberal open market-oriented framework that has governed economic policy making in most countries over the past two decades. One major element has been the lack of public investment in agriculture and in agricultural research. This has been associated with low to poor yield increases, especially in tropical agriculture, and falling productivity of land. Greater trade openness and market orientation of farmers have led to shifts in acreage from traditional food crops that were typically better suited to the ecological conditions and the knowledge and resources of farmers, to cash crops that have increasingly relied on purchased inputs. But at the same time, both public provision of different inputs for cultivation and government regulation of private input provision have been progressively reduced, leaving farmers to the mercy of large seed and fertiliser companies, input dealers. As a result, prices for seeds, fertilisers and pesticides have increased quite sharply. There have also been attempts in most developing countries to reduce subsidies to farmers in the form of lower power and water prices, thus adding to cultivation costs. Costs of cultivation have been further increased in most developing countries by the growing difficulties that farmers have



in accessing institutional credit, because financial liberalisation has moved away from policies of directed credit and provided other more profitable (if less productive) opportunities for financial investment. So many farmers are forced to opt for much more expensive informal credit networks that have added to their costs.

The lack of attention to relevant agricultural research and extension by public bodies has denied farmers access to necessary knowledge. It has also been associated with other problems such as the excessive use of ground water in cultivation; inadequate attention to preserving or regenerating land and soil quality; the over-use of chemical inputs that have long run implications for both safety and productivity. Similarly, the ecological implications of both pollution and climate change, including desertification and loss of cultivable land, are issues that have been highlighted by analysts but largely ignored by policy makers in most countries. Reversing these processes is possible, and of course essential. But it will take time, and also will require not only substantial public investment but also major changes in the orientation and understanding of policy makers.

While these remain urgent issues that require global and national policy interventions, the intensity of the food crisis that hit many developing countries (including those in Asia) in 2008 was particularly on account of the dramatically high global prices of important food items, which adversely impacted upon national food security for food deficit countries, and their partial pass-through to national economies, which in turn affected the food security of vulnerable groups within countries.



It is now quite widely acknowledged that financial speculation was the major factor behind the sharp price rise of many primary commodities, including agricultural items over the past year (UNCTAD 2009, IATP 2008, 2009, Wahl 2009, Ghosh 2009). Financial deregulation in the early part of the current decade gave a major boost to the entry of new financial players into the commodity exchanges. Unlike producers and consumers who use such markets for hedging purposes, financial firms and other speculators increasingly entered the market in order to profit from short-term changes in price. There was a consequent emergence of commodity index funds that were essentially 'index traders' who focus on returns from changes in the index of a commodity, by periodically rolling over commodity futures contracts prior to their maturity date and reinvesting the proceeds in new contracts. Such commodity funds dealt only in forward positions with no physical ownership of the commodities involved. This further aggravated the treatment of these markets as vehicles for a diversified portfolio of commodities (including not only food but also raw materials and energy) as an asset class, rather than as mechanisms for managing the risk of actual producers and consumers.

As the global financial system became fragile with the continuing implosion of the US housing finance market, large investors, especially institutional investors such as hedge funds and pension funds and even banks, searched for other avenues of investment to find new sources of profit. Commodity speculation increasingly emerged as an important area for such financial investment. The United States became a major arena for such speculation, not only because of the size of its own crisis-ridden credit system, but because of the deregulation mentioned above that made it possible for more players to enter into commodity trading.

This created a peculiar trajectory in international commodity markets. The declared purpose of forward trading and of futures markets is to allow for hedging against price fluctuations, whereby the selling of futures contracts would exceed the demand for them. This implies that futures prices would be lower than spot prices, or what is known as backwardation. However, throughout much of the period January 2007 to June 2008, the markets were actually in contango, in which futures prices were higher than spot prices. This cannot reflect the hedging function and must imply the involvement of speculators who are expecting to profit from rising prices. Indeed it has been argued that contango was so strong that the futures markets were essentially driving the spot prices up in this period. Then, by around June 2008, when the losses in the US housing and other markets soared, it became necessary for many funds to book their profits and move resources back to cover losses or provide liquidity for other activities. UNCTAD (2009: 25) notes the sharp decline of financial investment in commodity markets from mid 2008. This caused futures market prices to fall, and this transmitted to spot prices as well.

The result was the excessive volatility displayed by important commodities over 2008. Such volatility had very adverse effects on both cultivators and consumers of food. This was not only because it sent out confusing, misleading and often completely wrong price signals to farmers that caused over sowing in some phases and under cultivation in others. In addition, it turns out that while the pass through of global prices was extremely high in several Asian developing countries in the phase of rising prices, the reverse tendency has not been evident in the subsequent phase as global trade prices have fallen. So both cultivators and food consumers appear to have lost in this phase of extreme price instability, with the only gainers from this process therefore being the financial intermediaries who were able to profit from rapidly changing prices.

There are other mechanisms through which the financial crisis itself operates to increase food insecurity. These work through the constraints the current crisis is imposing on fiscal policies in balance of payments constrained developing countries and the effects of capital flows upon exchange rates, as well as through the adverse impact upon livelihoods and employment, which reduces the ability of vulnerable groups to purchase food.

Similar tendencies are evident in the world oil market. Both structural factors and speculations have contributed to steep increases in crude oil prices. Important structural factors include growing demand, supply pressures and constraints, depleting reserves and turbulent geo-political situations. However, more recently speculative investment has played a key role in the oil futures market, similar to the role outlined above for essential food commodities. The rise in crude prices in recent years has been driven partly by the rapid growth in demand. Chart 16 shows oil consumption to be consistently higher than that of oil supply. Before 2003, the gaps were due not to a real supply shortfall but mainly to the OPEC cartel's control of production. But in recent years, growth in demand has strained physical supply boundaries, as the supply gap is more real and market-determined. Since 2006, the supply and demand gap has been further widening. In the past, fluctuations in oil supply and demand have been dampened by three main buffers: surplus production capacity among OPEC members, large oil inventories, and surplus refining capacity in consuming countries. All three buffers have, however, been shrinking. As a result, the world oil market has become more vulnerable to even slight changes in supply and demand. This has been exacerbated by shrinking oil stocks, as oil companies have been holding lower stocks of crude oil and gasoline in order to cut costs. Oil prices also have been affected by security and political issues, linked primarily to apparently unstable political and military configurations and possible terror attacks in the Middle East and West Asia.

The rise in crude prices in recent years has been driven partly by the rapid growth in demand. Before 2003, the gaps were due not to a real supply shortfall but mainly to the OPEC cartel's control of production.

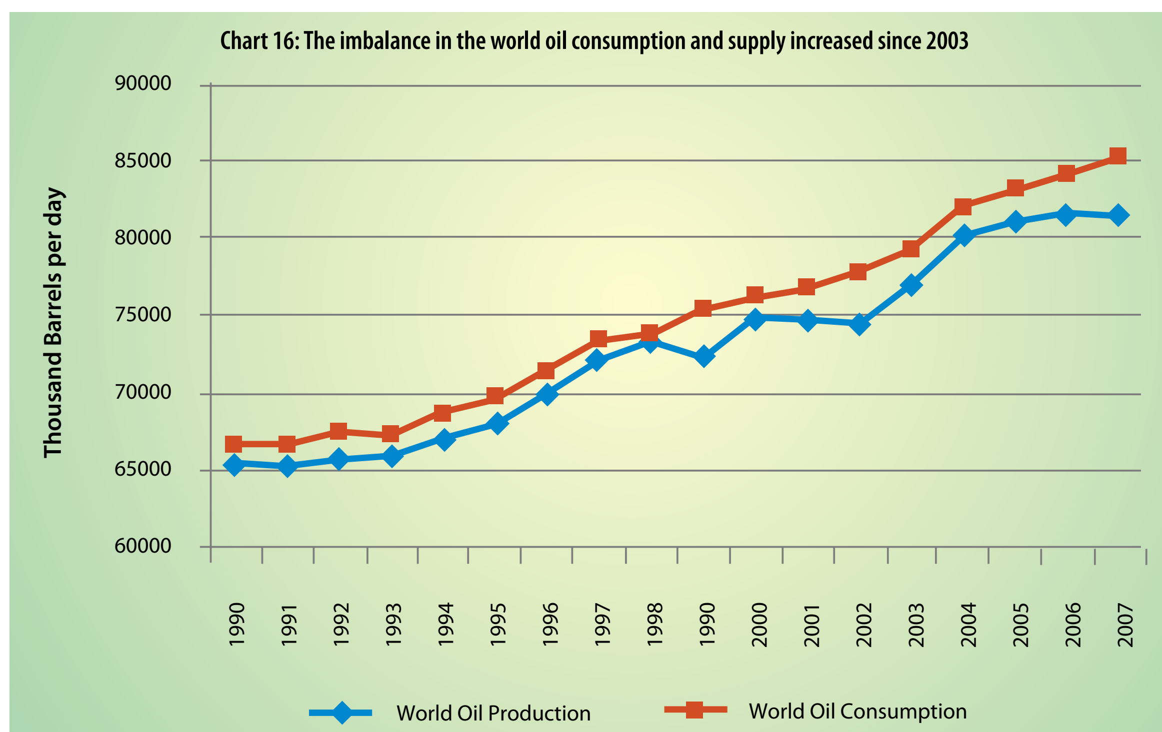


Chart 16: The imbalance in the world oil consumption and supply increased since 2003

Source: UNDP(2007)

These oil supply-demand imbalances and uncertainties were exacerbated by a massive influx of speculative money into the market for crude oil futures. Speculators, reacting to vulnerabilities in supply and external shocks, have expanded their trading, often basing their judgments on media reports. In so doing, they have heightened the price volatility in the short-run. Speculative activity can push oil prices higher, since this unstable situation adds a larger 'risk premium.' While the decline in oil prices over June 2008 to March 2009 provided some relief, the situation is by no means resolved. Over the short term, futures prices may once again be subject to excessive hikes that bear no direct relation to current supply or demand fundamentals. However, these prices can themselves trigger further changes in supply or demand situation, leading to another round of wild fluctuations. This is particularly so since investor behaviour in oil futures markets and therefore oil price changes incorporate an element of 'geopolitical risk premium' in addition to purely economic assessments.

5.2 Effects through External Trade

At the macro level, the impacts of higher food and oil prices on countries are likely to be diverse depending upon whether countries are net importing or net exporting countries, as well as the relative share of net food and oil exports (exports-imports) in total imports or total domestic consumption or total domestic production. It is important to note that this can vary over time as sudden changes in output and relative prices can alter the situation. Even so, it may be useful to identify which countries are net food exporters or net food importers.

In Asia and the Pacific, 26 out of 35 countries are net food importers. Out of these, three are from East Asia, seven from South-West Asia, five from South East Asia and 11 are from the Pacific. Out of 26 net food importing countries, nine countries namely Papua New Guinea, Sri Lanka, Fiji, Solomon Islands, Mongolia, Indonesia, Malaysia, Tonga, and Lao PDR have trade surplus in agricultural products. It is true that

the negative effects of soaring food prices could be balanced out with positive effects of rising prices of agricultural raw materials. However, while prices of agricultural raw materials also experienced volatility in terms of big increases and then declines in the last two years, they did not increase as much as those for food items, and the subsequent fall tended to be steeper as well. Given market imperfections and the high degree of monopsony prevailing in most cash crop markets in developing Asia, it is unlikely that actual cultivators benefited greatly from the brief phase of extremely high international prices of most agricultural raw materials, including oilseeds and cotton.

Only nine out of 26 net food importing countries in this region can be considered as vulnerable in the sense that their net food imports are more than 5 % of their total imports. These nine countries are Kiribati, North Korea, Micronesia, Cook Islands, Samoa, Bangladesh, Papua New Guinea, Nauru and Palau. Out of these, one country - Papua New Guinea - has huge trade surplus on agricultural trade. Fortunately, none of the countries in Asia and the Pacific can be considered to be highly vulnerable in terms of having net food imports more than 10 % of their total imports. Most of the food net importing countries are small island states or countries in conflict (Afghanistan, Nepal, Sri Lanka) or major non-food commodity exporting countries (Indonesia, Iran, Lao PDR, Malaysia, Mongolia) or industrial countries (South Korea and Singapore). Other than these, only a few countries such as Bangladesh, Bhutan, and North Korea turn out to be particularly vulnerable to global food price shocks. However, even so food prices have tended to increase quite sharply in a much wider range of countries in Asia and the Pacific, even in those that are not directly vulnerable through imports.

Table 9: Many Asia -Pacific Countries are net food and agricultural importers in 2004-05 (two years average)

	Food items (cereals, pulses, meat, dairy, vegetables and fruits)		All Agricultural products	
	Net Importer	Net Exporter	Net Importer	Net Exporter
East Asia	North Korea, South Korea, Mongolia	China	North Korea, South Korea, China	Mongolia
South West Asia	Afghanistan, Bangladesh, Maldives, Nepal, Sri Lanka, Bhutan, Iran	India, Pakistan	Bangladesh, Maldives, Nepal, Bhutan, Pakistan, Iran,	India, Sri Lanka
South East Asia	Indonesia, Malaysia, Singapore, Lao PDR, Cambodia	Vietnam, Thailand, Myanmar, Philippines	Singapore, Cambodia, Philippines	Malaysia, Vietnam, Indonesia, Thailand, Lao PDR, Myanmar,
Pacific	Kiribati, Micronesia, Cook Islands, Samoa, PNG, Nauru, Palau, Fiji, Solomon Islands, Tonga, Marshall Islands	Vanuatu, Tuvalu	Kiribati, Micronesia, Cook Islands, Samoa, Palau, Nauru, Tuvalu, Marshall Islands	Tonga, PNG, Vanuatu, Fiji, Solomon Islands
No. of countries	26	9	20	15

Source: Francis NG & M. Ataman Akoy, "Who Are the Net Food Importing Countries", Policy Research Working Paper 4457, World Bank, Jan 2008.

Nine countries in Asia and the Pacific have been net food exporters in recent years. These include Myanmar, Tuvalu, Thailand, Pakistan, Vietnam, India, China, Vanuatu and Philippines. Out of these only few countries namely Myanmar, Tuvalu and Thailand have reasonably high net food exports in terms of their total import bill. Half of the countries that have surplus in food trade are nevertheless net importers of agricultural products. These include Tuvalu, Pakistan, China and Philippines. This implies that only four countries in Asia and the Pacific have trade surplus both in food and all agricultural products. These are Myanmar, Thailand, Vietnam and India. From a macro perspective, only these four countries could be expected to benefit at all from higher prices of food grains and agricultural raw materials.

This classification of food exporting and importing countries is based on total food trade involving all items such as cereals, pulses, meat, dairy, vegetables and fruits, etc., taken together. But it is also illuminating to examine patterns of exports and imports in individual or major food grain categories, which can have particular effects on domestic consumption and food security.

For net food importing countries, vulnerability to changes in global food prices also depends upon the Import Dependency Ratio (IDR), which defined as net imports (exports –imports) as % of domestic consumption. Table 11 classifies countries using the IDR for individual food commodities and groups of commodities.

Only few countries namely Myanmar, Tuvalu and Thailand have reasonably high net food exports in terms of their total import bill.

Table 10: Many Asia -Pacific Countries are net food and cereals importers in 2003-08 (Five years average)

Food grains	Cereals	Rice	Wheat	Corn
South Korea	South Korea	Philippines	Indonesia	South Korea
Indonesia	Indonesia	Indonesia	Philippines	Malaysia
Iran	Philippines	Bangladesh	South Korea	Iran
Philippines	Malaysia	Malaysia	Bangladesh	Indonesia
Malaysia	Bangladesh	Iran	Vietnam	Vietnam
Bangladesh	Iran	North Korea	Malaysia	North Korea
Sri Lanka	Sri Lanka	PNG	Thailand	Bangladesh
Afghanistan	North Korea	Sri Lanka	Sri Lanka	Philippines
North Korea	Papua New Guinea	Nepal	Iran	Nepal
Papua New Guinea	Mongolia	Lao PDR	Mongolia	Pakistan
Mongolia	Nepal	Mongolia	China	Bhutan
Fiji	Bhutan	Fiji	Pakistan	Afghanistan
Nepal	Afghanistan	South Korea	North Korea	Fiji
Laos			PNG	
Bhutan			Nepal	
			Bhutan	
15 out of 21 countries	13 out of 21 countries	13 out of 20 countries	16 out of 17 countries	13 out of 18 countries

Source: Palanivel (2008)

In Asia and the Pacific, 15 out of 21 countries for which data are available have had deficits in food grains trade over 2003-08. This implies that only six countries, namely Thailand, India, China, Pakistan,

	Food grains	Cereals	Rice	Wheat	Corn
High import dependency - more than 60 % of domestic consumption are from imports	Papua New Guinea, Fiji, Malaysia, Rep Korea, Mongolia	Papua New Guinea, Malaysia		Indonesia, Vietnam, Sri Lanka, Malaysia, Thailand, Philippines, Mongolia, Bangladesh, Rep Korea, PNG	Malaysia
Modest import dependency - more than 10 % but less than 60 % of domestic consumption are from imports	Sri Lanka, Philippines, DPR Korea, Iran, Afghanistan, Indonesia	Malaysia, Rep Korea, Mongolia, Sri Lanka, Bhutan, Philippines, DPR Korea, Indonesia, Iran,	PNG, Malaysia, DPR Korea, Iran, Philippines,	DPR Korea, Bhutan	Rep Korea, Bangladesh, Iran, DPR Korea, Indonesia, Vietnam
Low import dependency - less than 10 % of domestic consumption are from imports	Bangladesh, Bhutan, Nepal, Laos	Bangladesh, Nepal, Afghanistan	Mongolia, Sri Lanka, Bangladesh, Indonesia, Nepal, LAOPDR, Fiji, Rep Korea	Iran, Nepal, Pakistan, China	Philippines, Nepal, Pakistan, Bhutan, Afghanistan, Fiji

Table 11: Food import dependency during 2003-07

Source: Palanivel (2009)-estimated from data obtained from USDA database

Vietnam and Cambodia, were net food grain exporters in the region in those years. Even this does not indicate national food security, as these are countries where domestic harvest changes and relative prices can significantly affect the pattern of exports and imports. Further, in several of these countries (such as India and Pakistan) there is clear evidence of poor nutrition and food insecurity of a significant proportion of the population even in a macroeconomic context of net food grain exports.

When trade in cereals as a group is examined, in addition to these six, two more countries namely Myanmar and Lao PDR have surpluses. With regards to trade in rice, seven countries were net exporters in the last five years; but with regards to trade in wheat, only India turned out to be a net exporter. In fact India also imports wheat frequently. Five countries are net corn exporters.

Table 12: Only one fifth of Asia and the Pacific countries are net food grains exporters during 2003-08

Food grains	Cereals	Rice	Wheat	Corn
Thailand	Thailand	Thailand	India	China
India	China	Vietnam		India
China	India	India		Thailand
Pakistan	Viet Nam	Pakistan		Myanmar
Vietnam	Pakistan	China		Lao PDR
Cambodia	Myanmar	Cambodia		
	Cambodia	Myanmar		
	Lao PDR			
6 countries	8 countries	7 countries	1 country	5 countries

Source: Palanivel (2008)

In Asia and the Pacific, most countries are net oil and gas importers. Only six out of 35 countries are net exporters of oil and gas in the region.

Similarly, for net food exporting countries, potential gains from changes in food prices may depend on the Export Orientation Ratio (EOR) defined as net exports (exports –imports) as percentage of domestic production. In Asia and the Pacific, three countries, namely Thailand, Vietnam and Cambodia have high export orientation ratio implying that over 10 % of their domestic production of food grains was exported over 2003-08. Pakistan has a moderate export orientation ratio, and India and China have low export orientation in terms of food grains. The largest net food grain exporting countries in terms of quantity of exports are Thailand, India, China, Pakistan, Vietnam and Cambodia.

In 2007, soaring food prices and consequently rising food exports and imports (including vegetable oilseeds and oils) affected the trade balance of developing countries by about 0.5 % of GDP in 2007. The Southeast Asian countries maintained a food trade surplus of the order of 1.9 % of GDP, while the deficit in the food trade of the East Asian countries increased slightly from 0.4 % of GDP in 2000 to 0.5 % in 2007. South Asia witnessed a fluctuating net food trade situation: moving from a food trade deficit (0.2 % of GDP) region in 2000 to a food surplus region (0.1 % of GDP) in 2006. Again, in 2007, it moved back to being a food trade deficit region (0.1 % of GDP). Net food imports of West Asia fell from 1.7 % of GDP in 2000 to 1.1 % in 2007. Similarly, net food imports of the Pacific decreased from 1.9 % of GDP in 2000 to 1.5 % in 2007 (UNCTAD 2008).

In Asia and the Pacific, most countries are net oil and gas importers. Only six out of 35 countries are net exporters of oil and gas in the region. They include Iran (with 4 % share of world exports and the sector contributing 20 % of GDP), Indonesia (world share 2.4 % and contribution to GDP 6.3 %), Malaysia (world share 1.2 % and contribution to GDP 7.4 %), Brunei Darussalam (0.6 % and 80 % respectively), Vietnam (0.6 % and 9.8 %) and Papua New Guinea (0.1 % and 13 %).

Some countries in the region produce crude oil, including Iran, China, India, Indonesia, Malaysia, Vietnam, Brunei Darussalam, Thailand, Papua New Guinea (PNG), and Timor-Leste. Out of this, only some countries are net oil exporters, who can realise benefits from high crude oil prices. Countries such as Mongolia and PNG also benefited from the surge in gold and copper prices. For Timor-Leste, government revenues from crude oil exports rose very significantly in 2007, while in Mongolia and PNG, government revenues from mineral exports rose substantially. In Timor-Leste and PNG, the high prices of exported

commodities more than offset the effect of high prices of imported food and petroleum products in net terms. This compares with a negative impact averaging between 5 and 6% and of GNI for other Pacific economies.

5.3 Domestic pass-through of prices

One feature of special concern is the evidence of relatively higher pass-through of the increase in global food prices during the period of price increase, with lower pass-through of the subsequent decline. Many Asian countries were affected by the extraordinary world price movements, although they were able to dampen the domestic impact of the extremely sharp spike that cause global prices to increase by around three and half times in the 18 months between January 2007 and June 2008. China appears to have handled the matter somewhat better, with rice prices broadly stable over the entire period despite the high global volatility. It is tempting to explain this in terms of domestic food self sufficiency that allowed China to insulate its population from the effects of high world prices in this basic food item, but this need not be the only reason. By way of contrast, India (which is also a large economy with domestic rice production several times the total volume of world trade) experienced quite significant increases in price of rice. Furthermore, these did not decrease commensurately with the global price, to the point that retail rice prices were 60 % higher in January 2009 in India than their level two years earlier. In an economy in which more than 90 % of workers' incomes are not indexed, such a substantial increase obviously has a big impact upon food access. Given the large proportion -- around half -- of those who are calorie deficient among the Indian population, this is obviously a matter of great concern.

Bangladesh and Sri Lanka also present contrasting cases. The results indicate that Sri Lankan consumers have shouldered more of the increase in world food prices than Bangladesh's. Similarly, if one compares

Table 13: Pass-through coefficients for food prices varied significantly across countries during 2006-08

Country	Cumulative Change in domestic food prices	Cumulative Change in world food prices	Cumulative Changes in Exchange Rate	World prices adjusted for exchange rate changes	Domestic price to world price (%) (Col-2/ Col-5)
Col: 1	2	3	4	5	6
Mongolia	60.5	67.4	-5.0	62.3	96.9
Sri Lanka	55.5	67.4	6.6	74.0	75.0
Maldives	45.0	67.4	1.1	68.6	65.6
Pakistan	40.7	67.4	27.2	94.6	43.0
Indonesia	35.5	67.4	-3.7	63.7	55.7
China	34.1	67.4	-17.4	50.0	68.2
Nepal	28.4	67.4	9.1	76.5	37.1
Bangladesh	28.1	67.4	6.5	74.0	38.0
India	21.9	67.4	4.6	72.0	30.4
Philippines	19.2	67.4	-25.7	32.9	41.7
Thailand	18.6	67.4	-16.0	51.5	36.2
Hong Kong	16.6	67.4	0.3	67.7	24.5
PNG	16.0	67.4	-15.0	52.3	30.6
Malaysia	13.3	67.4	-9.7	57.8	23.1
Singapore	13.3	67.4	0.5	67.9	19.7
Korea	10.2	67.4	3.3	70.7	14.5

Source: Palanivel (2008)

Mongolia and South Korea - both are net food importers - the results show that South Korean consumers have been more shielded from the price rise than Mongolian consumers. How did some countries manage to escape the worst effects of this volatility and keep their own prices relatively stable? The answers obviously lie largely with how domestic policies have functioned, but more importantly, also with the space for effective domestic policies that is determined by both the external environment and the country's mode of global economic integration.

The most direct link is through trade, with both food importers and food exporters affected. Countries in which a very large proportion of the basic food requirement is met through domestic supply (China and India) are therefore less likely to experience the volatility if they have in place adequate institutional arrangements to ensure domestic production and distribution. By contrast, food importers are obviously more vulnerable. It used to be thought that "large" economies -- those with the capacity to affect global prices through their entry or exit into world trade -- should be more worried, but with the advent of financial players in the grain markets, it is no longer evident that this by itself would have a direct impact on price. Rather, the impact is more likely to be indirect, through the impact upon the expectations of the financial players.

Table 14: Pass-Through Coefficients for oil prices vary significantly across countries as well as between diesel and gasoline during 2006-08

	Cumulative annual rates (%) of change in (2002-08)			Pass-through Coefficients (%)			
	Domestic retail prices in local currency		World crude oil prices in local currency	Diesel (2002-08)	Gasoline (2006-08)	Diesel (2006-08)	Gasoline (2002-08)
	Diesel	Gasoline					
Afghanistan	216	139	258	84	54	92	53
Indonesia	180	130	235	77	55	37	22
Malaysia	177	91	208	85	44	93	68
Sri Lanka	170	138	257	66	54	104	130
Lao PDR	170	142	205	83	70	121	82
Philippines	162	141	207	78	68	86	100
Vietnam	155	123	254	61	48	68	49
Bangladesh	151	134	266	57	50	77	109
Mongolia	150	135	241	62	56	56	42
Cambodia	146	95	245	59	39	123	77
Thailand	142	121	193	74	63	122	113
Nepal	118	82	214	55	38	62	114
Samoa	116	95	193	60	49	118	83
Korea, South	108	42	207	52	20	135	68
Pakistan	101	107	282	36	38	26	36
China	87	78	199	43	39	61	53
Fiji	79	70	180	44	39	58	49
Bhutan	72	61	215	34	28	21	34
India	64	50	215	30	23	4	26

Source: Palanivel (2008) - Estimated by UNDP staff using data from ADB, 2008b, GTZ, 2007 and OANDA, 2008.

Even so, some importing countries have managed to cope better than others. There is a range of possible interventions that have been made (FAO 2008), ranging from the reduction or suspension of import tariffs and taxes, to the imposition of export restrictions, support for domestic production with agricultural inputs and credit, intervening heavily in food markets, introducing food assistance programs and increasing subsidies. The countries that have managed to do these more effectively are those that have also managed to restrain or stabilize food price increases to some extent. In addition, some countries have taken measures to contain domestic speculation in food markets, either through banning commodity futures markets in grain trade (India).

The case of China is especially significant, because with its large population, any significant entry into global markets through additional import demand would naturally affect spot prices. Despite this, China has managed the food situation the most effectively among developing Asian countries, and this reflects not only its internal policies but two features that are particularly noteworthy: the greater strength and viability of its fiscal strategy, and its control over internal and external financial flows. These allowed for strategies to increase food supplies in the face of global market volatility, the continued spread of a public distribution system for essential food items and limits on domestic speculation in food prices. It is evident of course, that effective state intervention for food price stability and food security requires fiscal resources. This has become an important barrier to successful intervention to contain food price rises in many countries. Similarly, the exchange rate depreciations that were experienced by most other developing Asian countries in the period from June 2008 to April 2009 also played a role in keeping domestic food prices higher.

Similarly, rising global crude oil prices also contributed to high fuel inflation in many countries in recent years. Between 2003 and 2008, as global prices of fuel increased very sharply, there were significant surges in domestic fuel price inflation in countries such as Afghanistan (216 %), Indonesia (180 %), Malaysia (177 %), Sri Lanka (170 %), Lao PDR (170 %), Philippines (162 %) and Vietnam (155 %). In several of these countries, fuel price inflation was higher than aggregate inflation and contributing to underlying inflationary pressures.[7] On the other hand, relatively low pass-through ratios were observed for India, Bhutan, Pakistan, China and Fiji.

The price shocks in turn affect the fiscal situation in several ways. On the expenditure side, there are fiscal costs when food and oil-importing countries do not adjust domestic prices of food and petroleum products in line with border prices. Costs also rise when domestic prices adjust to world food and oil prices, and governments then raise social benefit payments or other transfers to moderate the impact on consumers. On the revenue side, there could be revenue loss due to lowering and exemption of Value Added Taxes, import tariffs and other taxes to mitigate the impact of higher world and domestic prices for food and petroleum products. Increases in oil and food prices also affect exports, imports and trade balance in many ways. The trade balance is expected to improve in food and oil exporting countries through the terms of trade effect, and to worsen in commodity importing countries due loss of export competitiveness and an increasing import bill. In addition to the financial burden of higher food and energy import bills, potential constraints on imports of necessities like food and raw materials have also sparked energy and food security concerns among importing countries.

The case of China is especially significant, because with its large population, any significant entry into global markets through additional import demand would naturally affect spot prices.

7. In the Pacific Island countries, all price rises have been passed-through to consumers, mitigated only by adjustments in tariff/excise rates and some concessions to public transport.

There is already evidence that rising food prices are likely to have affected household consumption and poverty in countries of developing Asia.

At the micro level, the impact of higher food and oil prices on the households are likely to be very diverse, depending upon the reasons for the price change and on the structure of the economy (Ivanic and Martin 2008). The impact could also vary depending upon household incomes and expenditures patterns, products involved, and policy responses of governments (World Bank 2008). Households usually spend about 40-60 % of their incomes on food items and therefore rising food prices are expected to increase households' consumption expenditure significantly. On the other hand, the incomes of farm households may be increased by higher food prices. Overall the impact of price shocks depends on whether the gains to farming households outweigh the adverse impact on consuming households. The benefits of higher food prices to average farm households may be lower, due to the limited extent of their net sales of food items. Since the majority of households, including in rural areas, are net buyers of food, the increase in food prices generally affects household consumption adversely.[8] To maintain a basic diet, poor households, especially in urban areas, are forced to increase their food expenditures at the expense of non-food expenditures such as medical care and education. The increase in fuel price also affects households adversely through raising the cost of agricultural production. In addition, diverting food for bio-fuel production aggravates supply and demand imbalances. As poor households often spend about three fourths of their incomes on food, fuel and transport, soaring food and oil prices jointly affect the poorest the most. This jeopardises progress towards attaining the Millennium Development Goals (MDGs) by risking gains made in reducing poverty and in increasing social cohesion. Hence, it is not surprising that increasing food and oil prices have triggered riots in many developing countries.

There is already evidence that rising food prices are likely to have affected household consumption and poverty in countries of

Table 15: Percentage Increase in the food cost (due to increase in cereal prices) of poor households is much higher than that of rich households during 2006-08

Quintiles	Bottom 20%	Q2	Q3	Q4	Top 20 %
Bangladesh	30.9	26.4	22.0	17.6	13.2
Cambodia	53.6	45.9	38.3	30.6	23.0
China	55.4	47.5	39.6	31.6	23.7
India	24.7	21.2	17.6	14.1	10.6
Indonesia	45.2	38.8	32.3	25.8	19.4
Mongolia	78.7	67.4	56.2	45.0	33.7
Nepal	30.1	25.8	21.5	17.2	12.9
Pakistan	34.9	29.9	24.9	20.0	15.0
Philippines	60.9	52.2	43.5	34.8	26.1
Singapore	16.0	13.7	11.4	9.1	6.9
Sri Lanka	60.9	52.2	43.5	34.8	26.1
Un-weighted Average	44.7	38.3	31.9	25.5	19.1

Source: Source: Palanivel (2008) - estimated by UNDP staff

8. This may not be so true in rural Pacific households where often two-thirds to three-quarters of food consumed by the rural poor is from own production.

Table 16: Percentage Decrease in the purchasing power (due to increase in cereal prices) of poor households is much higher than that of rich households during 2006-08

Quintiles	Bottom 20%	Q2	Q3	Q4	Top 20 %
Bangladesh	-19.9	-15.0	-11.1	-7.8	-4.1
Cambodia	-23.8	-17.8	-13.0	-8.8	-4.8
China	-28.8	-21.4	-16.2	-11.1	-6.4
India	-14.3	-10.6	-7.9	-5.4	-2.6
Indonesia	-26.7	-19.1	-13.9	-9.6	-5.0
Mongolia	-51.9	-35.6	-24.9	-15.5	-5.4
Nepal	-13.5	-11.1	-9.2	-6.9	-3.6
Pakistan	-17.1	-13.8	-11.0	-8.0	-4.1
Philippines	-26.2	-20.9	-14.4	-8.7	-3.7
Singapore	-20.0	-8.9	-4.8	-2.6	-1.0
Sri Lanka	-24.4	-17.2	-11.7	-7.3	-2.6
Un-weighted Average	-24.2	-17.4	-12.6	-8.3	-3.9

Source: Source: Palanivel (2008) - estimated by UNDP staff

developing Asia. In Vietnam, several studies found that rising food prices had probably led to increased incidence of poverty and cutback on other essential expenditure such as on heath care.

The analysis also shows that soaring cereals prices during 2006 - 08 reduced households' purchasing power substantially. On an average, estimates suggest that the purchasing power of poor households decreased by 24% in Asia and the Pacific, while that of rich households fell by only 4%. The decline of purchasing power varies from country to country. Real incomes of poor households in Mongolia declined by 51% because of food price changes, compared to 14% decline for poor households in India (Table 16).

In order to mitigate the adverse impact on consumers, governments intervene in food and energy markets in a variety of ways. Some governments in the food and oil importing countries directly intervene to control the quantity of imports as well as their distribution and prices. Some other governments allow the private sector to import and distribute food and petroleum products freely, but set price ceilings and compensate private sector distributors to cover any losses. In exporting countries, governments often set domestic prices below world levels, imposing an opportunity cost on farmers. Governments can also use fiscal and trade policies actively to mitigate the adverse impact of rising global food and oil prices, but this clearly depends upon the extent of "fiscal space" available. When rising food and oil prices cause an increase in overall inflation, countries' central banks may be prompted to react with monetary tightening. At the same time, governments and central banks also need to protect the interest of domestic producers. This complicates the policy making process, as policy makers have to tread a fine line between containing inflation and supporting the growth process. As global food and fuel prices once again show signs of increase from June 2009 onwards, these problems are likely to become significant again for developing Asia. This also underlines the crucial need for active public intervention to regulate financial speculation in commodity futures markets.

REFUSED?

NEED CREDIT?

DECLINED?

REJECTED?

TURNED DOWN?

CHAPTER 6

6 CHAPTER

The Social Impacts of the Crisis

The social impacts of the crisis tend to be more dramatic in developing countries, particularly Least Developed Countries (LDCs), not only because of the lower average incomes but because they typically have weak social safety nets. These provide insufficient protection in case of unemployment and cover only a small fraction of the labour force in the formal sector, while a large proportion of workers are employed informally. Formal statutory social protection programmes such as old age and disability benefits, pension systems, etc. tend to be limited in their coverage and do not include the self-employed, the part-time employed, daily labourers in urban centres who come from rural areas, laid off workers in SMEs, agricultural labourers, domestic workers, migrant workers and those working in the informal sector.

6.1. Employment patterns

The most obvious and direct impact of the crisis is obviously the effect on employment. In fact employment losses have tended to be more severe than GDP losses, largely because the worst affected productive sectors have been those that are export-oriented and more labour intensive. Further, it is likely that recovery in employment will be both delayed and less dynamic than the recovery in aggregate output. Since most developing Asian countries have large informal employment and higher rates of petty self-employment it is likely to be expected that the impact on employment would be reflected in greater disguised unemployment, more casual work and lower wage incomes rather than in increases in open unemployment.

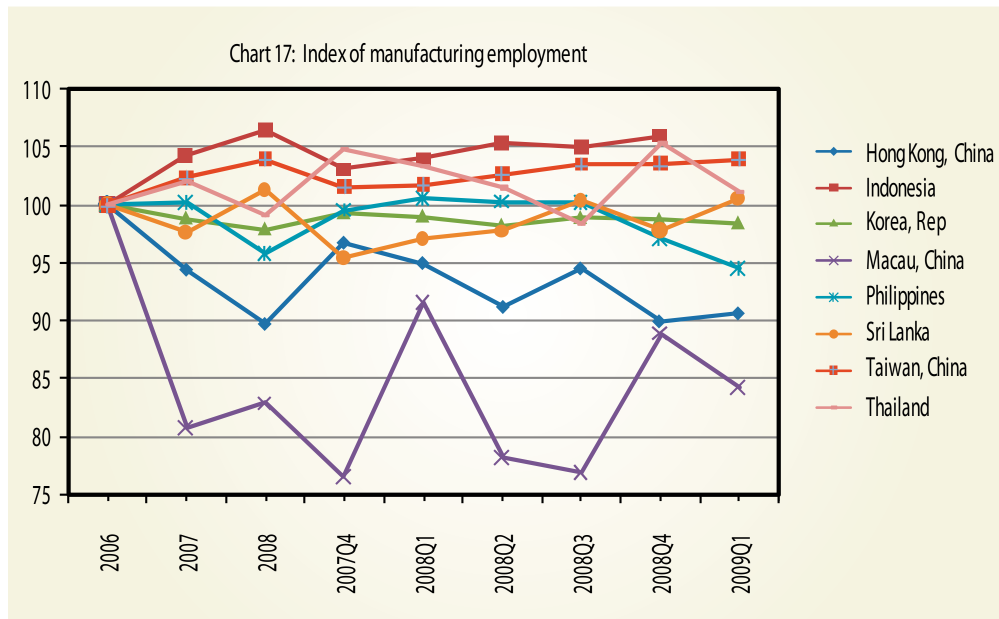
Since exports have been directly and immediately affected, and since manufacturing exports were among the major growth forces in large parts of developing Asia, it was expected that employment in manufacturing production would be immediately hit. However, the evidence on aggregate manufacturing employment in countries that do provide recent monthly data is still somewhat mixed. As Chart 17 indicates, the index of manufacturing employment has been volatile around a declining trend in Macau (China), Hong Kong (China) and the Philippines. But it has shown no clear trend in Thailand and Sri Lanka, and the index even increased just slightly in Indonesia and Taiwan. Since these are all economies whose exports have declined since the middle of 2008, it may be that the initial impact on export sales has yet to be translated into cutbacks in production and employment. Of course, these data rely on recorded employment in manufacturing, and it is likely that a significant amount of informal work in manufacturing is not recorded, so such data may be misleading.

In any case, this aggregate information is somewhat contradicted by the evidence emerging from the country case studies, which suggests that the impact on employment is already quite apparent at different levels. Two types of effects on employment can be identified: those on workers who are directly affected by loss of employment, either through complete job loss or reduction in the number of working days or downward pressure

on wages; and those on workers who are indirectly affected by the adverse multiplier and linkage effects of the primary employment reduction. The workers who are directly affected include the workers in export industries (such as garment workers), construction workers, tourism industry workers, farmers of selected crops and internal and cross-border migrant workers. Those who are indirectly affected include self-employed workers and those

Available evidence shows that employment growth has decelerated sharply in the last decade compared to 1980s. This is particularly so in East Asia. Consequently, the open unemployment rate has increased recently in many East Asian countries. This has happened against a relatively higher GDP growth in the 1990s. Consequently, the employment elasticity has declined in the last decade in Asia. When China data was excluded from Asia, then the decline in

The crisis has hit hardest those groups which were already having trouble finding and keeping jobs, such as youth and older workers.



Source: ILO Laborsta database, accessed in July 2009.

working in small scale enterprises and in informal activities to supply goods and services within the domestic economy, including to the directly affected workers.

The crisis has hit hardest those groups which were already having trouble finding and keeping jobs, such as youth and older workers. The low-skilled, and in particular low-skilled immigrants, were among the first to be laid off because they are concentrated in vulnerable sectors, such as construction or tourism, and often hold only temporary jobs. Open unemployment, and increasing underemployment initially affected the urban areas which were the major areas of factory employment for the rapidly growing export industries and the construction industry.

employment elasticity is very modest. Sub-regional estimates show that employment elasticity in South Asia has remained more or less at same rate of 0.30, while it declined sharply from 0.55 to 0.15 in East Asia in the same period mainly due to declining elasticity in China.

In Asia employment elasticity of GDP growth in general and manufacturing in particular has been low and falling, which in turn implies that growth rates of output would have to be very high for demand for labour to grow significantly. As Table 17 shows, employment elasticity in most Asian countries is generally low (below 0.4), which implies that a one percentage point in the GDP is associated with less than 0.4 percentage point increase in employment.

Agriculture is clearly no longer a refuge sector for those unable to find employment elsewhere – the data indicate low or even negative employment elasticity in this sector. The service sector, by contrast, seems to have emerged as the refuge sector in this region. With a few exceptions, employment elasticity in manufacturing has also declined.

quickly find their way to the developing countries when their economies are open. Since in developed countries, technological progress is generally associated with increases in labour productivity, producers in developing countries find that the pressure of external competition (in both exporting and import-competing sectors) requires them to adopt such technologies.

Table 17: Employment elasticity is low and declining in Asia-Pacific

	1980s	1990s
EAST ASIA & PACIFIC		
Agriculture	0.4	- 0.1
Industry	0.6	0.1
Services	0.7	0.5
Total	0.6	0.1
SOUTH ASIA		
Agriculture	0.4	0.2
Industry	0.3	0.4
Services	0.3	0.5
Total	0.3	0.3

Source: Palanivel, 2006

There are several reasons for such a decline, which has been noted in all the developing regions of the world. While tightening labour markets are evident in a few countries such as South Korea and Malaysia, most countries in the region are still characterised by excess labour reserves. The shift away from public sector based industrialisation, which tended to have more focus on employment creation, may also have played a role. Most significantly, economic openness tends to be associated with declining employment elasticity of output (or increases in labour productivity). This is because of the impact of trade liberalisation on the pattern of demand for goods and services within the country as well as on techniques of production. As tastes and preferences of the elites in developing countries are influenced by the "demonstration effect" of lifestyles in the developed countries, new products and processes introduced in the latter very

Further, competition in global markets creates pressures to reduce unit labour costs, and in high-exporting regions such as developing Asia, such pressures are particularly acute. As a result, many enterprises in the region tend to become more capital-intensive as they expand output, either because they have been investing in new or replacement labour-saving equipment, or because they have responded to competitive pressure either in the domestic or international markets by shedding labour. The impact of this is so strong that it more than counterbalances the impact of the global relocation of manufacturing production, which has been related to cheap labour in Asia. Thus even in China, aggregate manufacturing employment has not increased after 1997 despite manufacturing GDP growing rapidly.

Rising output without a corresponding rise in employment is obviously disadvantageous to the poor, despite the fact that it signals a rise in labour productivity. But what is more surprising is the continuing increase of labour productivity when output is decelerating or falling. There has been a disproportionate response of employment in the current slump, with evidence of job losses in export industries that are greater than would be expected given the change in output. In Sri Lanka, the collapse of some export employment appears to have generated an employment shift away from industry back to agriculture. The most dynamic sub-sector within manufacturing had been garments, but the post-crisis scenario has witnessed the closure of around 50 factories including 35 garments firms. As a result, employment in industry decreased by 4.8 %. But this was more than compensated by the 8.4 % increase in agricultural employment, which may be related to the policy support provided to ensure continued agricultural growth in this period. In Cambodia, where garment exports constitute 70 % of total exports, export growth has decelerated rather than turned negative thus far over the crisis. Even so, there has been net closure of 50 factories and the total number of full-time workers in the garment industry fell from 352,955 in September 2008 to 290,439 in April 2009, implying that 18 % of the total work force was laid off in the past eight months. Many more have been temporarily suspended or not provided with overtime work. In Bangladesh, workers in the garment industry who still retained their jobs reported that their earnings had fallen compared to the previous year, and were proving to be insufficient to meet minimum household expenditure including cost of children's education.

Across developing Asia, the garments industry that has been particularly adversely affected by the global slump largely employs young female workers, often migrants from rural areas. Women are typically the first workers to be laid off – both because the industries in which they predominate (e.g. textiles and garments) are those most affected by the crisis and because women are less unionised and therefore easier to sack. Women workers dominate in export-oriented manufacturing production across most of Asia, especially Southeast Asia, Bangladesh and Sri Lanka, with a ratio of two to five female workers for every male worker in sectors such as textiles, garments and electronics (Dejardin and Ownes 2009). Already female unemployment rates in South and Southeast Asia in 2008 were higher than male rates (6 % on average for females compared to 5.2 % for males, ILO 2009). It is well known from the experience of the Asian financial crisis a decade earlier that women workers are usually the first to be laid off, given the job segregation that puts them in the low paying and more "flexible" activities unlike the more diversified and relatively more secure occupations of male workers. For example, women were laid off at seven times the rate of men in South Korea (Seguino 2009). Initial evidence from several countries suggests that this is already happening in the current crisis.

This has particular human development implications, since the loss in such employment affects not only household incomes but also gender relations. In Cambodia, Thailand and several other countries, the case studies found that many such women have not returned to their rural homes following layoff, but continue to stay in cities looking for different jobs or staying with spouses, partners or other social contacts. Some have turned to work in the entertainment industry, including as open or disguised sex workers who are thereby exposed to the risk of contracting the HIV infection.

Other labour-intensive export industries that have been badly affected, such as leather, electronics and gems and jewellery, have reported closure of some units, labour retrenchment and declining real wages. In India, there are estimated to be more than 15

million women workers in the unorganised sector, and more than half of them are women involved in home-based work for different types of industry, dominantly on a piece-rate basis. These home-based workers are part of often complex production chains delivering goods for both external and domestic markets, which have been hit by falling orders and heightened competitive pressure. Very recent evidence from the case studies in Vietnam, Thailand and Sri Lanka suggests that as export-based industries such as garments face heightened competitive pressure, they pass this pressure on to home-based women workers by reducing the effective rates for 'piece-rate' work. Thus even nominal piece-rate wages have fallen in many such activities, even as prices of necessities such as food have continued to increase. Other quick surveys in India have found significant declines in both employment and real wages in such activities as diamond cutting and polishing, small scale engineering goods, automotive parts, and so on. A particular instance of dramatic declines in real incomes has been evident in the informal sector activity of waste sorting and collection. This is largely performed by economically and socially deprived groups, and the recent collapse of the recycling industry was associated in early 2009 with dramatic declines in piece rates to less than half their level of even a year before.

The construction industry has generally been adversely affected across developing Asia. In Cambodia, it is estimated that 30 % of construction jobs have disappeared since January 2009. Similarly, workers in the informal sector and those employed on a casual or daily basis have found it more difficult to get paid work in almost all affected countries. In Vietnam, day labourers interviewed in early 2009 reported a drop in the number of working days by 50 % and declines of wage income of 30-50 % as compared to 2008. This was found to be associated not only with declining consumption of the household but also withdrawal of children from school and greater incidence of child labour.

Such employment effects are associated also with the indirect multiplier effects of the crisis, which in many developing countries of the region have been associated not so much with increases in open unemployment rates (because of the absence of social safety nets such as unemployment benefits or insurance) but with greater disguised unemployment and falling remuneration. Thus, in areas where tourism is an important activity, in addition to those directly hit in the tourism industry, there have been secondary adverse effects on those providing related services. For example, in Siem Reap (near the famous Angkor Wat complex in Cambodia) in addition to hotels and restaurants, massage shops and beauty parlours, souvenir shops, local transport providers, fruit sellers and mobile food stalls, laundry services, and other local traders have all reported declining incomes in the past year. Similarly, in several areas where there has been significant closure of factories, such as Rajkot in the state of Gujarat, India, or in Dhaka Bangladesh or in Phnom Penh Cambodia, the various small businesses that catered to the needs of workers have been severely affected, and quick surveys have found that earnings of such related activities declined by about 30-60 % compared to the previous year. In the Tan Thuan-Export Processing Zone, near Ho Chi Minh City in Vietnam, loss of employment in and closure of some exporting factories was found to be associated with significant losses in incomes and livelihood of service providers (such as room rentals, restaurants, barber shops, etc) who had earlier catered to the workers.

In Cambodia, it is estimated that 30 % of construction jobs have disappeared since January 2009.

One feature that has not been widely noted in most recent analyses of the effects of the crisis but is nevertheless a cause for concern and possible future tension is the apparently rapid increase in youth unemployment in many countries. While the attention has been focussed on post-crisis job loss and newly laid off workers, the crisis has also meant dramatically reduced opportunities for new entrants to the work force at almost all levels of skill. In China the lack of sufficient job

options for millions of new graduates has been acknowledged as a potent source of possible social unrest, and in India as well educated unemployment has shown an increase. But the even greater danger may come from less skilled young workers – both male and female – who may find it difficult to enter the work force at all. In addition to the social problems this can cause, this affects future growth prospects of the economy because of the social waste of such unemployment and the absence of on-the-job training for such young people.

6.2. The Crisis and Agriculture

The current problems in farming have to be seen in the context of an agrarian crisis that has plagued many countries in the region for more than a decade. In several (but not all) countries in the region, public policies from the early 1990s onwards systematically reduced the protection afforded to farmers and exposed them to import competition and market volatility; allowed private profiteering in agricultural input supply and crop purchases without adequate regulation; reduced critical forms of public expenditure; tried to cut subsidies by increasing the prices of important inputs like fertiliser and water and electricity rates, ran down or destroyed important public institutions that have direct relevance for farming, including public extension services and marketing arrangements; and did not adequately generate other non-agricultural economic activities. At the same time various forms of public protection for cultivation were being reduced, trade liberalisation meant that farmers had to operate in a highly uncertain and volatile international environment. They were effectively competing against highly subsidised large producers in the developed countries, whose average level of subsidy amounted to many times the total domestic cost of production for many crops. In addition to increasing the risks of farming, volatile crop prices also generated misleading price signals. This caused large and often undesirable shifts in cropping patterns which ultimately rebounded on the farmers themselves.

Trade liberalisation meant that farmers had to operate in a highly uncertain and volatile international environment.

There was much greater use of a range of purchased inputs, including new varieties of seed and related inputs marketed by major multinational companies. Small cultivators, who took on debt (often from informal credit sources at very high rates of interest) in order to pay for these cash inputs, then found themselves in real difficulty if crops failed or output prices remained low. So the inevitable uncertainties associated with weather fluctuations were compounded by further problems of extremely volatile crop prices, which were no longer inversely related to harvest levels but followed an international pattern. Further, this dramatic volatility of output prices was associated with continuously rising prices of inputs. This was especially marked because of government attempts to reduce fertiliser subsidies, and progressive deregulation of supplies of inputs such as seeds and pesticides. For example, in Cambodia, a nationally representative survey of households found that labour cost increased by 47 % and agricultural production costs accelerated by 30 to 50 %, due partly to the tripling in the price of fertiliser and the 50 % increase in the price of diesel and gasoline (CDRI, 2008). Similar results have been reported in India, Indonesia, Philippines and Pakistan.

Such exposure to global price volatility was associated with a growing reliance on private debt, because of the lack of extension of institutional credit. In most countries of the region, deregulated finance was less willing to provide agricultural credit, and there was therefore a significant slowdown in the growth of bank credit, particularly from commercial banks to rural areas, the impact of which fell disproportionately on poor and small borrowers.

While global prices increased dramatically between late 2006 and mid 2008, many

cultivators in the region could not get the advantage of such hikes because farm gate prices did not change very much in most countries. Rather, the benefits of such price hikes were largely captured by large traders and speculators. The subsequent decline in global prices has however impacted upon farm gate prices especially for important cash crops, for which typically there are no price support mechanisms provided by governments. While the prices of major agricultural commodities declined quite sharply from their peak in June/July 2008, input prices continued to increase for most farmers. The oil price hikes of 2008 were translated into higher fertiliser and pesticide prices with a lag, and domestic increases in fuel prices also increased the cost of transportation of crops, use of machinery and other inputs. In several countries money wages in agriculture also increased because of food price increases (even though typically the increase was lower than that of the food price) leading to higher labour costs. Thus the very recent period has seen a growing problem of reduced financial viability of cultivation. All these difficulties are heightened in the case of women farmers, because in much of Asia (especially South Asia) lack of land titles and other recognition has tended to deprive them of benefits such as access to institutional credit, extension services, subsidised inputs, etc. They therefore tend to have higher costs of cultivation than their male counterparts, and less state protection. In turn they are also likely to be deprived of the benefits of any crisis relief packages in the absence of specific measures. It is worth noting that only 7 % of arable land in Asia is owned by women compared to around 18 % in Africa, which is the next lowest region.

However, in some countries where public policies have been more supportive of farming, agriculture has emerged as an important bulwark against the crisis. This is evident in Vietnam and Sri Lanka, where continued output growth in agriculture and higher rural incomes have served to mitigate the negative effects of the global crisis on manufacturing and some services.

6.3. Impact of Reduced Access to Credit

Borrowing has been an important coping mechanism for those badly affected by the crisis whether through job loss or through declining wage incomes or other routes. Various surveys conducted in the wake of the crisis in different countries have all found households in the first instance seek to increase their borrowing to shore up their consumption and maintain "desirable" expenditures such as education of children. However, in large parts of developing Asia, informal sector workers and cultivators have poor or non-existent access to formal credit institutions, such as banks and credit co-operatives, and even formal "micro-credit" institutions can provide only a small fraction of their needs especially in emergencies. Therefore they are driven to informal credit sources at very high rates of interest. This puts an enormous burden of debt on the household that affects their ability to recover from the crisis even when economic conditions improve.

In addition, small and micro enterprises face a significantly increased problem of inadequate access to credit. This is particularly important to note because typically most policy responses to the crisis in the region have tended to ignore the specific needs of such micro entrepreneurs and self-employed persons who constitute the bulk of employment. Women in particular find it difficult if not impossible to access institutional credit for productive purposes. This increases costs of operation and makes it even harder to be competitive in the much more difficult economic environment.

6.4 Impact on Migrant Workers

The impact of the global crisis on cross-border migration has already been discussed in an earlier section. But there are other human development implications of the impact upon migrant workers that need to be noted.

For example, in Bangladesh it was found that many migrant workers who travelled abroad in search of work often had to incur debt for large down payments to labour contractors and therefore were unable to generate much savings even after several years of work in often unsavoury conditions. The adverse economic situation in destination countries has made matters much worse for many of them who now are also unable to repay the debts they have taken on and feel unable to return home for fear of social censure.

When they lose their jobs they are forced either to stay in precarious conditions in the urban areas, or go back to their places of origin – villages or smaller towns. They consequently change from becoming providers of remittance incomes to their households, to becoming dependents of these households.

Internal migration has been an important feature of the export-led industrialisation process across developing Asia. The economic boom of the past decade relied heavily on such workers: not just in the export sectors themselves but in related labour-intensive services, such as cleaning, maintenance, private security, driving and related services. These were not simply informal activities: many of them catered to the requirements of the expanding corporate sector in the booming economies, and in effect subsidised it by providing a cheap and flexible external labour force. The direct and indirect employment effects of the crisis that were mentioned earlier have been most evident for such migrant workers. As migrants, they are typically denied the residence-based socio-economic rights that governments in the region recognise, even when they are employed. When they lose their jobs they are forced either to stay in precarious conditions in the urban areas, or go back to their places of origin – villages or smaller towns. They consequently change from becoming providers of remittance incomes to their households, to becoming dependents of these households, even as these households face more fragile material circumstances than before. Many of these migrant workers, for obvious reasons, come from more depressed and backward regions, where there is relatively less potential for productive income generation, and where remittance incomes can play a vital role in sheer survival. These problems have been noted for large countries such as China and India, but also in smaller countries such as the Philippines, Cambodia and Bangladesh.

The loss of remittance incomes has other effects within rural economies. A study by Cambodia Development Resource Institute found that 93 % of urban migrant workers remit money home to their villages, on average about US$20 per year. This suggests that internal migrants send home as much as US$150 million per year to rural Cambodia or about 8 % of the total income of rural households. In Nepal, remittance income is found to contribute as much as half of household income in certain pockets. As such remittances dwindle, this directly affects consumption, including of essential items.

6.5 Impact on Income Poverty and Human Poverty

There are particular concerns about the impact of the current crisis on poverty and inequality, because the earlier boom was characterised by increasing inequality and therefore the persistence of poverty in many countries. Several studies have found extremely adverse indirect effects of the crisis in terms of reduced household spending on essential items, for the reasons noted above. This was particularly marked among households where the main earner had recently lost employment or households that faced a significant decline in wage incomes or remuneration from

self-employment. Health and education spending appear to be the types of spending that are most affected. Several studies (especially in India, Cambodia, Vietnam, etc) reported not only reduced food consumption but also reduced health spending and avoidance of trips to medical personnel in order to reduce household costs. Withdrawal of children – especially girl children – from school or their shift to lower quality but less costly municipal schools was a very common response. Several cases studies found that the children were also put to work in order to increase family income and therefore the family's survival chances. Several surveys in India also noted some increase in domestic violence as the greater insecurities and frustrations of daily existence led male heads of households to vent their anger on the womenfolk. The withdrawal or reduction of public services, which has been part of the fiscal problems emerging from the crisis, usually put a greater burden on unpaid labour within the household. This is typically performed by women, and this too is already evident from quick surveys in different parts of developing Asia.

An economy-wide shock is likely to have heterogeneous impacts within any given country, depending on household demographics, education attainments and location. The impacts of a crisis on children are understandably of great concern. When poor families are compelled to cut short their kids' schooling in response to a shock this creates a lasting impact on poverty. This impact varies depending on the extent of the shock and initial conditions. Declining wages make child labour relatively less attractive and schooling more so, but (at the same time) lower parental incomes increase the value of the extra money that children can bring to the family budget if they work. The balance of these economic forces will vary from place to place. There is evidence that in low income countries schooling tends to decline in an economic crisis while in middle- and high-income countries schooling rates increase. Impacts on the nutrition of young children in poor families are also of special concern. A number of research findings suggest that poor nutrition in the early years of life retards child growth, cognitive and learning ability, schooling attainments and (in all likelihood) earnings in adulthood

The growth elasticity of poverty which indicates the percentage change in the incidence of poverty associated with a 1 % increase in per capita income varies widely across Asian countries. Among the major Asian countries, the Philippines is the only country where positive elasticity has been found implying that the growth of per capita income is not associated with a decline in poverty. In most Asian countries, the elasticity is negative implying that growth of per capita income associated with some decline in poverty incidence. On average, the growth elasticity of poverty reduction has been estimated at -0.8 for 13 Asian countries (Palanivel, 2008).

However, the pattern varies across countries and critically depends upon the nature of the growth, its sectoral content and the distribution of its benefits, in all of which state policies play an important role. It has been found that in China the most impressive reductions in poverty were concentrated in phases when the growth pattern favoured rural areas and improved the terms of trade of agriculture versus industry (Ghosh 2009). A similar result has also been noted for Indonesia: the astonishing egalitarian and poverty alleviating growth in Indonesia during the 1970s and the 1980s was principally due to a diversion of a high proportion of public investment towards the rural areas, and to reforms of the domestic trade and marketing regime, which led to an improvement of the agricultural terms of trade. When India experienced relatively fast agricultural growth (mainly due to the green revolution) in the 1970's and in the first half of the 1980's, poverty declined despite a relatively low rate of overall economic growth. However, the slowdown in agricultural growth in the 1990s and early part of this decade, despite high aggregate economic growth, had an adverse impact on poverty reduction.

Some countries have managed to reduce poverty fairly rapidly even in periods of relatively slow growth by ensuring that gains from such growth accrue relatively more to the poorer segments of the population. For example, despite only moderate annual growth rates of per capita income of 3 %, Malaysia and Sri Lanka in the 1980s were able to reduce poverty annually by as much as 4-7 % due to declining inequality. A striking case is that of Pakistan in the 1970s, when poverty declined despite slow growth (of less than 2 % per annum) and rising inequality. This can be traced to the rapid increase in labour migration of Pakistani workers to the Middle East in this decade, which led to large and growing inflows of remittances that contributed to poverty reduction at home.

Clearly, when inequality is rising, growth will have a less direct and beneficial impact upon poverty reduction (Bourgignon 2007). For the region as a whole, a one percentage point increase in the growth rate of per capita income has translated into only about 0.7 % - 0.9 % decline in the incidence of poverty. Inequality as a whole has worsened in the region since the early 1990s, and while it has been successful in achieving high rates of economic growth, it has implied slower progress in terms of poverty reduction. If economic growth is to be favourable to the poor, it should have a pattern that directs resources to the sectors in which the poor work (agriculture), areas in which they live (relatively backward regions), factors of production which they possess (unskilled labour) and outputs which they consume (such as food).

CHAPTER 7

7 CHAPTER

Policy Responses

Asia-Pacific countries found themselves in very divergent situations regarding the scope for fiscal stimulus and easing monetary policy, depending mainly on their initial fiscal and current-account positions. At the time of the crisis Asia's initial conditions were stronger than at any time in the past. As Table 18 shows, Asian countries (except perhaps Maldives, Pakistan, Sri Lanka and Viet Nam) enjoyed large policy space for counter-cyclical measures to address the crisis. These conditions gave Asian economies in general the space to move towards a more expansionary monetary and fiscal policy regime by cutting interest rates sharply and adopting large fiscal stimulus packages. As a result, overall domestic demand has held up remarkably well, despite the collapse of external demand.

Table 18: Availability of Policy Space

	Category	Countries
High policy space	Surplus or low fiscal and current account deficits	Bhutan, China, Indonesia, South Korea, Lao PDR, Nepal, Papua New Guinea, Philippines, Singapore and Thailand
Modest policy space	Low fiscal and high current account deficit	Cambodia, Mongolia, Samoa, Solomon Islands and Tonga
Modest policy space	High fiscal and low current account deficit	Bangladesh, India, Iran, Malaysia
Low policy space	High fiscal and high current account deficit	Maldives, Pakistan, Sri Lanka and Viet Nam

Note: Cut-off point is - 4. That is, current account or fiscal deficit is defined as "high" if it exceeds 4 % of GDP based on data of 2006-08.

7.1. Fiscal and monetary policies

Monetary policies were the first to be deployed once the adverse effects of the crisis in terms of asset market declines, exchange rate depreciations and domestic credit crunch began to be felt. Monetary policy in most countries of the region had been tightened from early 2008 in response to the sharp increases in commodity prices, which were feared to spark and inflationary spiral. In some countries, the deceleration in output could even be traced at least partially to such monetary tightening. However, by late 2008 almost all governments in the Asia-Pacific region were indulging in substantial easing of monetary policy, through reductions in prime lending rates and repo rates, increases in liquidity through changing of cash reserve rules and other central bank actions designed to make institutional credit more accessible. Measures were also taken to support domestic financial markets. Blanket guarantees on deposits, swaps to companies and banks needing foreign currency, and guarantees on external bond issuance for banks have all helped maintain confidence and sustain the banking systems' ability to play their intermediation function. By mid 2009 these appeared to have had some positive effect, even though credit remained tight especially for small entrepreneurs.

Despite a sharp depreciation of their currencies, the central banks of developing Asia reduced their interest rates significantly in late 2008.

Table 19: Interest Rates in Selected Economies in the last three years

	Interest rates (%)				Change in basis points			
	July 2007	July 2008	Dec. 2008	May 2009	July 2007-July 2008	July 2008-Dec. 2008	Dec. 2008-May 2009	July 2008-May 2009
China	3.33	4.14	2.79	2.79	81	-135	0	135
China, Hong Kong SAR	4.37	2.30	0.95	0.31	-207	-135	-64	199
India	6.00	6.00	5.00	3.25	0	-100	-175	275
Indonesia	8.25	8.75	9.25	7.25	50	50	-200	150
Malaysia	3.60	3.70	3.37	2.13	10	-33	-124	157
Pakistan	10.00	13.00	15.00	14.00	300	200	-100	-100
Republic of Korea	4.75	5.00	3.00	2.00	25	-200	-100	300
Singapore	2.56	1.00	1.00	0.69	-156	0	-31	31
Thailand	3.25	3.50	2.75	1.25	25	-75	-150	225
Developing Asia	**5.12**	**5.27**	**4.79**	**3.74**	**-14**	**48**	**105**	**152**
Australia	6.25	7.25	4.25	3.00	100	-300	-125	425
Japan	0.50	0.50	0.10	0.10	0	-40	0	40
Developed Asia	**3.38**	**3.88**	**2.18**	**1.55**	**-50**	**170**	**63**	**233**
Argentina	9.34	8.98	11.12	10.82	-36	213	-30	-184
Belarus	9.70	10.40	19.00	17.90	70	860	-110	-750
Brazil	11.25	13.00	13.75	10.25	175	75	-350	275
Canada	4.50	3.00	1.50	0.25	-150	-150	-125	275
Chile	5.25	7.25	8.25	1.25	200	100	-700	600
Czech Republic	3.00	3.75	2.25	1.50	75	-150	-75	225
Euro area	4.00	4.25	2.50	1.00	25	-175	-150	325
Hungary	7.75	8.50	10.00	9.50	75	150	-50	-100
Iceland	13.30	15.50	18.00	13.00	220	250	-500	250
Latvia	5.21	5.40	8.92	10.78	19	352	186	-538
Mexico	7.25	8.00	8.25	5.25	75	25	-300	275
Norway	4.50	5.75	3.00	1.50	125	-275	-150	425
Poland	4.50	6.00	5.00	3.75	150	-100	-125	225
Russian Federation	10.00	11.00	13.00	12.00	100	200	-100	-100
Saudi Arabia	5.06	3.82	2.55	0.85	-124	-127	-170	297
Serbia	9.50	15.75	17.75	14.00	625	200	-375	175
South Africa	9.50	12.00	11.50	7.50	250	-50	-400	450
Sweden	3.50	4.50	2.00	0.50	100	-250	-150	400
Switzerland	2.71	2.76	0.66	0.40	5	-210	-26	236
Turkey	17.50	16.50	15.70	9.50	-100	-80	-620	700
Ukraine	9.00	15.90	14.80	17.20	690	-110	240	-130
United Kingdom	5.75	5.00	2.00	0.50	-75	-300	-150	450
United States	5.25	2.00	0-0.25	0-0.25	-325	-175	0	175
Other regions	**7.27**	**8.22**	**8.70**	**6.78**	**-94**	**-49**	**192**	**144**

Source: UNCTAD (2009)

Despite a sharp depreciation of their currencies, the central banks of developing Asia reduced their interest rates significantly in late 2008. Developed Asia also reduced their policy rates substantially. In the first half of 2009, the central banks of Asian economies moved further towards a more expansionary monetary policy. In the aftermath of the financial crisis, developing Asia reduced their interest rates by an average of 152 percentage points and developed Asia by 233 percentage points (Table 19). Consequently money and credit aggregates recorded rapid growth in many Asian countries in the last one year. Aggressive monetary policy easing by regional central banks has contributed to Asia's recovery.

Only Pakistan, where monetary policy is being operated under IMF programme, interest rates remained high (at 14 %), as fighting inflation with a restrictive monetary policy has taken priority over countercyclical demand stimulation. The degree of interest rate easing in Asia stands out compared with that in previous business cycles or other regions. The median policy rate has declined by about 2.3 percentage points, about five times as much as in previous recessions. Lending rates, however, have declined by smaller amounts, raising questions about whether monetary transmission mechanisms have buckled under the strain of the global crisis. IMF (2009) research suggests this is not the case.

Table 20: Summary of policy actions taken in North America, Europe, Asia and the Pacific

	CA	US	EU	CH	UK	AU	CN	HK	IN	ID	JP	KR	MY	NZ	PH	SG	TH
Ease monetary policy	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√	√
Introduce fiscal stimulus		√	√		√	√	√	√	√	√	√	√	√	√	√	√	√
Liquidity assistance in local currency	√	√	√	√	√	√		√	√	√	√	√		√	√		
Lend foreign exchange	√		√	√	√	√			√	√	√	√		√	√	√	
Expand deposit insurance		√	√		√	√		√		√		√	√	√	√	√	√
Guarantee non-deposit liabilities	√	√	√		√	√						√		√			
Prepare bank capital injection		√	√	√	√		√	√	√		√	√					√
Create demand for assets	√	√	√	√		√	√		√	√	√	√	√				
Impose short sale restrictions	√	√	√	√	√	√		√		√	√	√				√	
Relax mark to market rules		√	√2	√	√					√	√	√	√		√		

CA = Canada; US = United States; EU = Euro area; CH = Switzerland; UK = United Kingdom; AU = Australia; CN = China; HK = Hong Kong SAR; IN = India; ID = Indonesia; JP = Japan; KR = Korea; MY = Malaysia; NZ = New Zealand; PH = Philippines; SG = Singapore; TH = Thailand. 1 As of July 2009. This table summarises policy actions proposed but not necessarily implemented.

Source: Bank of International Settlements (2009)

Proactive fiscal policy came into play by late 2008. Most countries in the region engaged in some fiscal expansion, with the exception of some financially constrained aid-dependent economies as well as countries like Pakistan that were forced to accept stringent policy conditions in exchange for emergency financing from the IMF. Table 20 provides a schematic survey of the various elements of the crisis response policy packages in major countries in Asia and the Pacific, North America and Europe, while details of the fiscal stimulus are given in Annexe 1. Direct comparisons between countries are difficult because the fiscal packages vary in terms of their time horizon: they extend over a period of between one and three years. However, the largest and most significant fiscal stimulus package was that of China (amounting 12-13 % of GDP over the two year; as per IMF, this is only about 6 % of GDP) but there were also large fiscal packages in Malaysia (9 % of GDP), Singapore (8 %), Vietnam (8.3 %) and South Korea (6.2 %). Other governments also announced fiscal packages, though these were typically much smaller in relation to GDP, such as India (1.8 %), Philippines (3.1 %) and Thailand (3.4.1 %). Since China is such a large player in the region, and since the need to shift from external demand to domestic consumption is the greatest in that economy, the quick fiscal response was certainly very welcome. The Chinese fiscal plan also has had the interesting result that it has shifted the geographical sources of demand from the eastern coastal region (which had hitherto dominated in growth) to the relatively neglected western and central regions.

Table 21: Fiscal Stimulus and support to the Financial System in Selected Economies							(Per cent of GDP)
	Fiscal Stimulus [a]	Support to the Financial system [b]	Year to spend fiscal Stimulus		Fiscal Stimulus [a]	Support to the Financial system [b]	Year to spend fiscal Stimulus
Developed economies [c]	3.7	48.5		Developing economies [c]	4.7	2.9	
Australia	5.4	9.5	3	Argentina	6.4	0.9	1
Austria	1.2	35.4	2	Brazil	5.6	1.5	1
Belgium	1.4	31.0	2	Chile	2.8	0.0	1
Canada	4.1	24.8	3	China	6.2	0.5	2
France	1.5	19.1	2	Hong Kong SAR China	2.4	0.0	1
Germany	3.6	22.2	2	Taiwan Province of China	2.1	0.0	1
Greece	0.8	11.6	1	India	1.8	6.4	3
Hungary	-7.7	9.1	2	Indonesia	2.0	0.1	2
Iceland	-7.3	263.0	2	Malaysia	2.8	6.3	2
Ireland	-8.3	266.4	3	Mexico	1.6	0.0	1
Italy	0.3	3.3	2	Peru	3.2	0.0	2
Japan	4.7	22.3	3	Philippines	3.1	0.0	1
Netherlands	2.5	46.5	2	Republic of Korea	6.2	20.5	3
Norway	1.2	17.8	1	Saudi Arabia	9.2	9.4	3
Poland	1.2	3.2	2	Singapore	8.0	0.0	1
Portugal	0.8	14.4	1	South Africa	7.4	0.0	3
Spain	3.9	22.9	3	Thailand	3.4	0.0	1
Sweden	3.3	70.2	2	Turkey	1.1	0.5	2
Switzerland	0.5	12.0	2	Transition economies [c]	5.8	7.4	
United Kingdom	1.9	81.7	3	Kazakhstan	11.1	0.0	2
United States	5.5	81.1	3	Russian Federation	5.4	8.0	2
Total [c]	4.0	36.1					

Source: UNCTAD (2009)

a Corresponds to discretionary measures on public spending or revenues in response to the financial crisis, excluding the "automatic stabilizers".
b Comprises capital injection, purchases of assets, lending by government treasuries, central bank support provided with treasury backing, liquidity provision by central banks and guarantees, excluding deposit insurance provided by deposit insurance agencies. Liquidity provision by central banks only includes the new special facilities established to address the present crisis and excludes the operations of the regular liquidity facilities.
c Country grouping weights based on current dollars.

Asia's fiscal stimulus has differed from that in other regions on three aspects: first, the size of fiscal stimulus; on average, in Asian economies, fiscal stimulus in 2009 amounts to about 2.7 % of GDP, compared with about 2 % on average in the G-20. Second a greater reliance on spending than tax measures. Asian economies devoted about 80 percent of their discretionary fiscal stimulus to increased spending, against about 60 % in the G-20.

The value of the fiscal packages amounts to 3.7 % of GDP, on average, in developed countries, 4.7 % in developing countries and 5.8 % in transition economies (Table 21). Compared to other regions, fiscal (and monetary) responses of Asian economies in general have been rapid and comprehensive due to its relatively strong initial conditions. According to the IMF (2008), Asia's fiscal stimulus has differed from that of other regions on three aspects: first, the size of fiscal stimulus; on average, in Asian economies, fiscal stimulus in 2009 amounts to about 2.7 % of GDP, compared with about 2 % on average in the G-20. Second a greater reliance on spending than tax measures. Asian economies devoted about 80 percent of their discretionary fiscal stimulus to increased spending, against about 60 % in the G-20. A large component of this spending has been focused on infrastructure. In addition, many governments have also tried to cushion the social impact of the crisis by allocating more resources to social safety nets—including rural pension reform and the provision of better public health, housing, and schooling in China; the expansion of employment guarantees and housing programmes in India; and benefits to those unemployed who attend job training schemes in Singapore. Third - faster implementation. Close to 50 % of the stimulus has been implemented on average in Asian economies, well above the G-20 norm, driven primarily by strong implementation of spending programmes. However, the speed of implementation has differed widely across the region, having been relatively slow for the industrial economies and fast for China, India, and the ASEAN economies (IMF, 2008). This strong fiscal response has played an important role in stabilizing Asian economies during the first half of 2009.

It appears that the fairly large fiscal stimulus of the Chinese government, along with other measures to ease interest rates and increase credit access, have worked in terms of increasing both domestic demand and economic activity in China. Thus, while exports have slumped in response to the global trend, domestic demand and retail sales have picked up. As a result, preliminary data for the second quarter of 2009 suggest that GDP is growing by nearly 9 % at an annualised rate, and industrial production in June was 10.7 % higher than it was in the same month of the previous year.

However, not only countries in the region have the fiscal space or the freedom in terms of balance of payments to engage in desirable countercyclical measures. In some countries of developing Asia, the crisis has also been associated with a fiscal crisis of the state, and some countries (such as Pakistan, Sri Lanka and Mongolia) have already had to approach the IMF for emergency assistance. Unfortunately, the IMF, which now accepts the need for countercyclical macroeconomic policies in the developed countries, still insists on very harsh pro-cyclical policies in the developing world, and forces governments to cut back on expenditure and raise user charges for public services in order to reduce fiscal deficits. This has meant reduced access to crucial public services. When combined with the effect of losses of livelihood and wage incomes, the effect can be disastrous.

Such adverse effects are not inevitable, since they can be ameliorated or even reversed by policy measures. But the extent to which different governments in Asia can undertake effective policy responses is conditioned by the extent to which they have been affected by the crisis in the first place. In particular, the extent of financial contagion and possible local financial crisis has depended on how far the developing country concerned has gone along the road of financial liberalisation. Countries with large external debts and current account deficits (such as Pakistan and Sri Lanka) have faced particular problems. The developing countries that have gone furthest in terms of deregulating their financial markets along the lines of the US (for example Indonesia) have been badly affected. By contrast, China, which has still kept most of the banking system under state control

and has not allowed many of the financial "innovations" that are responsible for the current problem in developed markets, is relatively safe.

The degree of flexibility available to different countries of developing Asia in terms of fiscal space varies greatly. Most Asian countries have followed prudent fiscal policies during the recent period of strong growth, and have also accumulated substantial foreign exchange surpluses that could be used as a hedge against capital flight in the event of financial markets' discomfort with larger fiscal deficits. As a result, "fiscal space" has been generated that could be used to boost domestic demand, through automatic stabilisers to work or countercyclical policies. Most East Asian countries (China, Malaysia, Korea, Singapore, and Thailand) have sufficient fiscal space to boost social spending to reduce the high level of precautionary saving and thus keep growth relatively high. On the other hand, most South Asian countries and some East Asian countries like the Philippines and Vietnam have relatively little room to manoeuvre owing to high fiscal deficits, relatively high levels of public debt and current account deficits that continue to require external financing. The ability to engage in expansionary fiscal policy has also been severely constrained in some countries by resources and the continuing explicit or implicit conditionality of international sources of funds. Thus the IMF package for Pakistan explicitly requires a reduction in the fiscal deficit from 7.4% of GDP to 4.2% through lowering public expenditure, gradually eliminating energy subsidies, raising electricity tariffs by 18% and eliminating tax exemptions. In other Least Developed Countries, the drying of ODA in the aftermath of the crisis has also played an extremely adverse role in reducing the possibility of countercyclical fiscal policy.

It is not only the size of the fiscal stimulus that matters, but its composition, which plays an important role in determining both the output growth and the human development effects of the package. Fiscal policy that provides more wage income directly to unskilled workers and in rural areas is likely to be much more effective in increasing aggregate incomes than other forms of public spending, because of the higher value of the multiplier in such expenditure. That is why the recent emergence of certain automatic stabilisers in government spending in India (such as the National Rural Employment Guarantee Scheme, or NREGS) had some effect in mitigating the very adverse impact of employment and wage income losses due to the crisis. This more "inclusive" form of public spending is not only desirable from a social or welfare perspective – it also provides very direct economic benefits because it is much more effective in dealing with the slump. Therefore the NREGS is about more than equity; it is also a macroeconomic weapon against slump, and this is at least partly so because it does generate more equity. All this is of significance because it means that even without increases in the level of the fiscal deficit, changes in the composition of public spending – towards rural areas and more backward regions, towards agriculture and employment intensive non-agricultural activities, towards ensuring universal provision of basic needs such as food, low cost housing, health services, etc. – can have significant positive effects in ameliorating conditions of life and contributing to wage-led recovery and growth.

While the global crisis has been associated with synchronic movements of output, there are signs that developing Asia, or at least some countries in the region, are likely to emerge from the crisis faster. To a significant extent, the recovery in some countries in the region has been associated with quick and proactive countercyclical monetary and fiscal policies that were designed to avoid the kind of sharp collapses in output and employment that were experienced most recently during the Asian crisis of the earlier decade.

On the other hand, most South Asian countries and some East Asian countries like the Philippines and Vietnam have relatively little room to manoeuvre owing to high fiscal deficits, relatively high levels of public debt and current account deficits that continue to require external financing.

7.2. Financial regulation

The UN Commission on regulating finance (the Stiglitz Commission) has already made a number of valuable suggestions with respect to recommendations at the international level for regulating finance so as to ensure that it meets the basic goals of international financial intermediation and stability. While some economists have been pointing out for some time that finance is special for a variety of reasons (including asymmetric information, and associated propensity for adverse selection, moral hazard, and the like, taken in combination with the crucial role banking plays in lubricating a market economy) this is now more widely accepted in the wake of the global crisis. But the pre-crisis experience has also shown that the globalisation of finance necessarily leads to regulatory arbitrage and tax arbitrage, even though both regulation and taxes are in the interests of nations and societies. How to resolve these contradictions is at the heart of the current discussions on future pathways of financial regulation, both nationally and at the international level. The need to establish sound and efficient systems of financial regulation and supervision is clearly one of the important lessons from the crisis; another is the need to ensure that financial innovations are sensible and do not disguise risk in the name of reducing it.

These issues are especially important in Asian developing countries because it is widely perceived that financial widening and deepening still have a long way to go in this region. Indeed, the divergence between domestic savings and investment rates (the so-called "savings glut") has been blamed on inadequate development of financial institutions. However, it should be noted that developing Asia is extremely diverse in this respect, and some of the countries that have exhibited the greatest savings surpluses (such as Malaysia, Indonesia and South Korea) are precisely those who have had the most deregulated, financially sophisticated and globally integrated financial systems especially since the Asian crisis. The role played by falling investment rates in creating the savings surplus has already been discussed; what should be recognised here is that the export of capital from such economies did not reflect lack of financial development in these countries any more than it did in Germany and Japan, which also exported capital to the US in this period. It is certainly true that China and India remain relatively more regulated especially in terms of banking (although in these countries as well the trend has been towards further liberalisation) but this is now recognised to be a major factor behind the relative financial stability exhibited by these countries before, during and after the crisis. However, insufficient financial widening – in particular the lack of extension of institutional credit and formal insurance to major segments of the economy such as small and medium firms, producers, cultivators and informal sector producers - remains an important constraint on both development and equitable growth in most Asian countries, and this needs to be addressed.

Two extensions to these proposals may be noted. First, given the highly unequal and potentially contractionary effects of devaluation upon developing countries, which in turn have adverse impacts upon real wages and essential consumption, it is necessary to encourage developing countries in Asia and elsewhere to institute capital management techniques that will control the destabilising flows of capital that cause havoc in exchange rates. Second, the crucial interaction between food and finance that was noted in Chapter 3 needs to be recognised and dealt with. It may now be a good time to consider restricting capital inflows in order to avoid a future bubble. If such an option is now not feasible, it may also be prudent to establish a substantial regional financial facility that can help countries deal with their weakened national currency. The

recent announcement of a US$ 120 billion facility under the Chiang Mai initiative is a good start that must be developed further and help avoid ad hoc arrangements.

It is true that the resolution of the global food crisis requires policies in the real economy, such as government interventions to provide more public support for sustainable and viable cultivation patterns and to create and administer better domestic food distribution systems; and international arrangements and co-operative interventions, such as strategic grain reserves, commodity boards and other measures to stabilise world trade prices. But dealing with the food crisis also definitely requires specific controls on finance, to ensure that food cannot become an arena of global and national speculation. These controls should include very strict limits (indeed bans) on the entry of financial players into commodity futures markets; the elimination of the "swap-dealer loophole" that allows financial players to enter as supposedly commercial players; and the banning of such markets in countries where public institutions play an important role in grain trade.

7.3 Redirecting production and demand to resolve external and internal imbalances

One of the important factors that made the current crisis so extensive was the previous build-up of what are clearly unsustainable global imbalances. To a significant extent these reflected the varying growth patterns in the US (which involved large and growing current account deficits) and in some countries of developing Asia like China, along with other net exporting countries like Germany (where the growth was based on large and growing current account surpluses). The unwinding of these imbalances is both inevitable and necessary, but for these to occur in a manner that does not generate painful restructuring in both sets of economies, active policy intervention is required. In the United States, the recession is already working towards reduced imports and increased exports, involving some decline in the current account deficit, while the winding down of private debt and growing protectionist pressures are likely to lead to further changes in this direction. In the near future, it is extremely unlikely if not impossible for the US economy to serve as the global growth engine in the same manner as in the recent past.

This means that the mercantilist obsession with increasing net exports, which has formed the underlying principle for recent growth strategy in the surplus countries, must be discarded. Despite clear indications to this effect, it is fair to say that export-led growth still remains the basic economic strategy in the Asian region, even in countries where the quantitative share of exports is not that large, and even in countries with current account deficits. For example, recent growth in most South Asian countries has been driven predominantly by domestic consumption and domestic investment. External demand, as measured by merchandise exports, accounts for less than one sixth of GDP in these economies. However, global integration has still played an important role, either by providing the qualitative catalyst for recent growth or by encouraging capital inflows that generated domestic asset booms and high animal spirits. In most East and Southeast Asian countries, exports contribute very large shares of GDP and the reliance on external demand is both more open and more explicit. Given the sharp decline and projected stagnation in export demand, particularly from Northern markets, it is critical that domestic demand rises rapidly in these countries. Since market functioning is likely to lead to the opposite outcome (because loss of business confidence and jobs are likely to curb domestic consumption growth across the region) it is necessary for government policies to be proactive in this regard.

The unwinding of these imbalances is both inevitable and necessary, but for these to occur in a manner that does not generate painful restructuring in both sets of economies, active policy intervention is required.

There have already been significant moves towards this, especially through extension and deepening of bilateral and regional free trade agreements that have promoted more cross-border trade and investment and strengthened regional supply chains across developing Asia.

Redirection and diversification of external demand away from excessive dependence upon Northern markets will clearly require greater emphasis on more trade within the region and South-South trade. There have already been significant moves towards this, especially through extension and deepening of bilateral and regional free trade agreements that have promoted more cross-border trade and investment and strengthened regional supply chains across developing Asia. The potential for expansion in such areas is now greater than ever before. In the past, South-South trade has been constrained by the lack of resources to lubricate such trade in the form of trade credit, investment flows and aid-for-trade arrangements. Such a resource constraint is no longer operative for the region as a whole, given the large volume of external reserves held by the aggregate of countries in the region as well as the large current account surpluses run by some countries. Therefore it is possible to conceive a broader regional strategy (along the lines of a Marshall Plan for the South) where by China and other surplus countries make financial resources available to other countries in the region to import their goods, in a mutually beneficial arrangement. Some initial moves in this direction are already being made, for example through the substantial expansion of credit advanced to partner countries by the China Exim-bank, but there is much scope for further expansion of such tendencies. In addition, improvement of intra-regional trade facilitation procedures and infrastructure and transport linkages are likely to play a significant role in contributing to future economic dynamism in the region.

It is evident that as the process of global economic rebalancing gets under way, developing Asia (and the surplus countries like China in particular) can no longer depend on exports as its primary engine of growth. It has been pointed several times in this study that Asia's record growth performance has come at a price. High rates of saving and investment, combined with respectable rates of technological progress have been the main drivers of Asia's capital intensive, non-agriculture-based export-led growth. While this did serve the region well in many respects, there are macroeconomic downsides to this growth pattern. The first is that it may not be possible to finance the current capital intensive mode of growth in the long run. Over time, more growth has come from capital accumulation, and less from employment and productivity increases. For developing Asia to continue on the same trajectory, rates of saving and investment would need to increase to more than half of GDP, which would be difficult as the economy matures. Secondly, this pattern of growth has created fewer jobs than a more labour intensive pattern, and has in the process increased urban-rural inequality.

Thirdly, and most central to the financial crisis, is the issue of global macro imbalances, particularly between the US and East Asia. From the external perspective, accelerating manufacturing production means continued strong export expansion and increase in the current account surplus and foreign exchange reserves. The growing US trade deficits against emerging economies like China in recent years have triggered intense debate over global imbalance. Of course, it makes little sense to blame China alone for the trade imbalance, since as a low-labour-cost country, China is naturally positioned to gain a larger manufacturing share in the international market as it is increasingly integrated into the global economy. However, the very high rates of domestic saving (significantly in excess of the high rates of domestic investment) obviously play a role.

Several factors have been cited as possible contributors to the recent surge in East Asian private savings rates. These include rapid GDP growth; increased uncertainty in the wake of the Asian crisis, which led to an increase in precautionary saving; the region's ongoing demographic transition, in which the average age of its population is increasing; and financial

development, which may have either a positive or a negative impact on saving. For example, the precautionary motive for saving is very strong among Chinese households because of the lack of an adequate pension system and the sharply rising costs of health care. Demographic factors add to this saving motive. The one-child policy instituted in the 1970s to control population growth has intensified the aging of China's population. The need to finance education expenses has also bolstered saving. The slow development of financial markets in China has meant limited availability of credit, so that households generally have to save in order to purchase big-ticket items, like houses and cars, rather than being able to borrow against future income. It also has meant that there are low returns on households' financial assets and limited opportunities for portfolio diversification, since there are few alternatives to depositing savings in state-owned banks.

Fourthly, the current growth pattern has contributed to growing inequality. Accumulation of capital in industry and services has led to starkly widening productivity differences, which in turn have led to large rural and urban income inequalities. This is because Asia's heavy reliance on manufacturing and services meant that urban formal sector jobs became rapidly more productive, and wages rose in line. As a result, agricultural incomes increasingly lagged behind average income per capita, contributing to inequality. During the last decade, Gini coefficients of many Asian countries rose to 0.40 or above, and several Asian countries are now similar to Latin American countries in terms of income inequality.

Finally, developing Asia's heavy reliance on industry for growth and its rapid rates of urbanisation have put increasing strains on the environment. Overall, the region has dramatically improved the efficiency of use of natural resources and energy over the past two decades. Nevertheless, environmental constraints on growth now loom large. The issues extend beyond climate change per se to over-extraction, degradation, pollution and congestion, which are among the more pressing problems facing citizens of the region today.

On current trends, Asia's growth imbalances—with growth driven by investment in industry and services in urban areas, environmental strains, and income inequality—are likely to become worse. Governments in the region are becoming more aware of these challenges and of the need to change the pattern of growth. A more balanced approach can boost social welfare by using its savings more productively. It would mitigate the return of the unsustainable current account surpluses that helped feed the current crisis. Of course, the current economic downturn is likely to reduce developing Asia's current account surplus to some extent. However, the slow projected pace of surplus reduction over the next few years suggests that rebalancing the region's growth or, equivalently, the reduction of the region's excessive dependence on external demand, will not happen automatically. Instead, a wide range of government policies, ranging from boosting domestic consumption to promoting more competitive domestic markets, will be required to facilitate the transition of the region to a more balanced growth path. Governments can play a major role in influencing the saving and consumption behaviour of households, particularly through provision of education, health care and pensions. Reducing uncertainties in these areas could substantially diminish the strong precautionary saving motive among households and give them the confidence to raise their consumption. The focus should be on structural reforms that would stimulate a more permanent increase and make GDP growth more balanced over the medium term, rather than look for short-term fixes for increasing private consumption.

Some policies that would contribute to such rebalancing include:

- Fiscal stimulus to boost domestic consumption and expanding health, education and pension systems, so as to reduce incentives for precautionary household savings.
- Government investments in public infrastructure (like roads and ports) and social infrastructure (education) will raise returns to private investment.
- Price and tax measures to support rural development and agriculture , to adjust the relative attractiveness of tradable over non tradable sectors and to redirect patterns of consumption and production.
- Financial development based on greater financial inclusion needs to be accelerated.
- More emphasis on R&D that develops new green technologies and is appropriate to the specific level of development of the country concerned and its own constraints and context.

7.4. Supporting agriculture and promoting faster rural development

During the 1990s, the share of government spending on agriculture declined sharply throughout the region, with the exception of some countries such as Sri Lanka and Vietnam. This trend will have to be reversed. It has been found that the greatest impact on agricultural productivity and poverty comes from investment in infrastructure such as roads, irrigation, village electrification, and from outlays on agricultural research and development and extension. In addition, relative price movements (the inter-sectoral terms of trade) and institutional changes such as land reforms or allowing peasant producers greater autonomy (as in the case of China) can be important. Fortunately, the importance of agricultural growth and rural employment programmes are being increasingly recognised. In India, the share of government spending on agriculture increased after 2004, and consequently, agricultural growth – with the benefit of some good monsoons – also accelerated from 2 % per annum during 2000-04 to 4 % during 2005-08. Rural development expenditure also increased, in particular through the National Rural Employment Guarantee Scheme (NRGES) which is discussed in more detail below.

Policies for promoting faster agricultural development may focus on the following:

- Higher priority in public sector allocations to rural development, especially in building rural infrastructure.
- Ensuring food security through increases in agricultural productivity, changes in cropping patterns, and sustaining the viability of cultivation.
- Effective and equitable management of water resources in ways that avoid the de facto privatisation of ground and surface water supplies.
- Diversification of agriculture into labour–intensive high-value agricultural commodities such as horticulture and livestock for increased profit incentives and employment opportunities. This may require intervention by the state initially in the process of marketing and in providing minimum support prices to help farmers manage the risks of moving into new economic activities.
- Creating financial inclusion to ensure that farmers and other rural producers have access to affordable banking and insurance services.

- Strengthening of the backward and forward linkages between the agricultural sector and the off-farm sector in the rural areas in order to create a virtuous cycle of growth of incomes and employment.

- Development of small and medium–scale rural enterprises for agricultural processing and provision of agricultural inputs will require greater outreach for extension of rural credit, both farm and off-farm, by financial institutions, specialised or otherwise.

7.5 The significance of social protection

Almost all countries had in place some kind of social insurance system and some kind of social assistance (Table 22). Most of these schemes, even when available in developing countries, are accessible only to formally employed workers. Since such workers constitute a small proportion of the total workforce in most Asia-Pacific developing countries, the coverage of these schemes tends to be limited. Even in China, social insurance was until recently restricted to the urban population and it is only recently that the government making a concerted effort to offer it to migrants and to the rural population. In sum, in most countries available social insurance largely bypasses the informal and rural sectors where most of the workers and much of the poor are present. The countries where this is less true are the developed countries such as Japan and the Republic of Korea, and some Central Asian countries (Chart 18).

Table 22: An Overview of Social Protection Systems in Asia and the Pacific

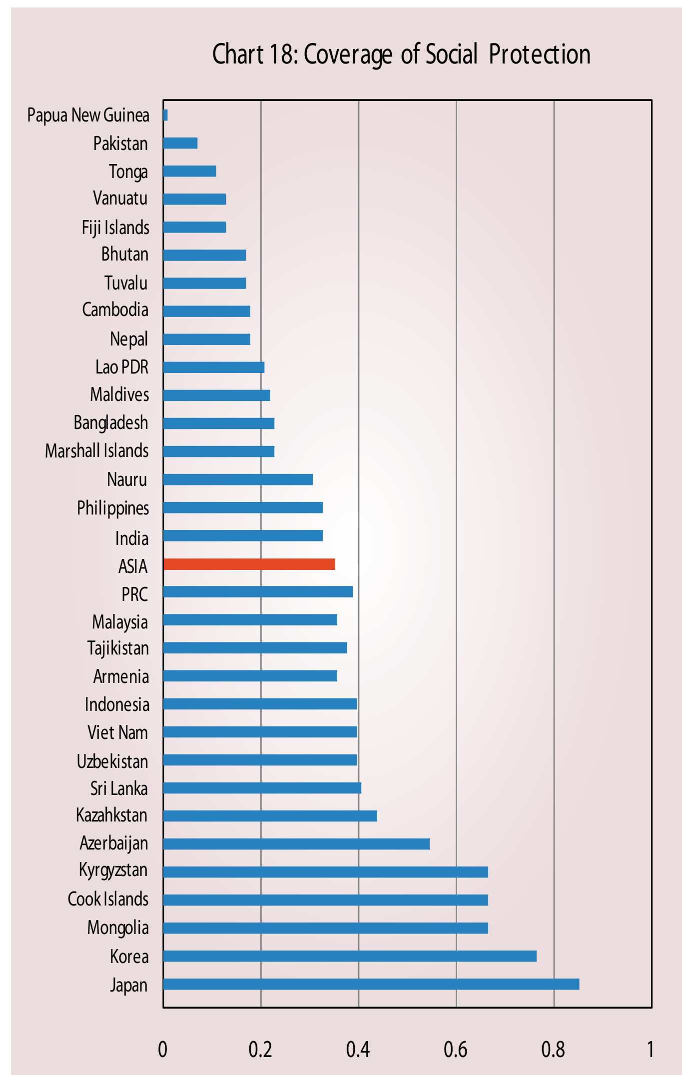
Country	Labor Market and Social Insurance initiatives	Social Assistance and Welfare Service Programs (including social sector initiatives)				Emergency Transfers	Child Protection
	Sickness, unemployment, old age, health, insurance (e.g public service, formal sector).	Poverty related: (universal or means tested)	Health related transfers (e.g. maternity benefits)	Education related transfers (e.g. school meals, stipends)	Employment related transfers (e.g. public works schemes)	Transfers to cope with shocks, conflict and natural disasters	
Afghanistan	X	X			X	X	
Bangladesh	X	X	X	X	X	X	
Bhutan	X	X		X			
Cambodia	X	X		X	X	X	
China	X	X	X	X	X	X	X
Fiji	X					X	X
India	X	X	X	X	X	X	
Indonesia	X					X	X
Korea (ROK)	X		X	X	X		X
Lao PDR			X		X	X	
Malaysia	X	X			X	X	X
Maldives	X	X		X		X	
Mongolia	X		X	X	X		
Nepal	X	X	X	X	X	X	X
Pakistan	X	X	X	X	X	X	X
PNG	X					X	X
Philippines	X			X	X		
Samoa	X					X	
Sri Lanka	X	X	X	X	X	X	
Thailand	X	X	X		X	X	X
Vietnam	X		X	X	X	X	

Sources: UNDP Staff based on Government Line Ministries (Health, Education, Planning, Finance), ADB, ESCAP, UNICEF (Koehler et al, Social Protection in South Asia: A Review 2009), World Bank, ILO

A major concern in the region is that the coverage of basic social protection programmes is very low (Chart 18). For example, for the region as a whole, only 30% of the elderly receive pensions, and only 20% of the unemployed and underemployed have access to labour market programmes, such as unemployment benefits, training or public works programmes, including work-for-food programmes. Health care has emerged as one of the biggest issues: only 20 % of the population has access to health care assistance, and Asia has the highest rates of out-of-pocket health care expenditure in the world.

The financial and economic crises in the 1990s highlighted the importance of effective social policies to cushion the impact of adverse economic developments. Already, as has been noted above, the case studies show that some features observed in earlier crises are already emerging within developing Asia: significant increases in the proportion of people in extreme poverty and without jobs or access to essential services, as well as rising rates of malnutrition and school dropouts among poor children. These conditions tend to aggravate chronic poverty and may lead to irreversible losses in human capital among the poor and vulnerable, undermining an economy's ability to sustain growth. Moreover the case studies also show that many of the affected are not adequately protected by any of the social assistance and insurance schemes in place.

Sound information and monitoring and evaluation systems are important for an effective social policy response. The information problems are compounded in a crisis, in which it is hard to know where the short-term impacts are greatest and how well policy responses are working. Various types of data are needed, including household and enterprise surveys and data on public spending.



Source: ADB (2008)

At the same time, countries need urgent action to ensure that the most vulnerable are protected in the short-term while they are putting the global economy back on the path to economically, socially and environmentally sustainable growth. However, the need for a fast response means that adapting existing programmes may be more effective than creating new ones. In countries hard hit by the crisis, there is a strong case for the expansion of appropriate forms of social protection to minimise the impact on the poor. However, short-term action must be consistent with longer-term structural reforms. Therefore governments may need to provide short-term relief by extending unemployment benefits and subsidising employment in certain sectors or for certain groups. Moreover care has to be taken not to create an over-dependence on benefits which would persist even after economic recovery. They need to be temporary and targeted.

Clearly Asian economies need to look for home grown solutions that build on Asian conditions such as the existence of large informal sectors, large working poor, high prevalence of malnutrition, high vulnerability to extreme poverty, and on traditions such as self reliance and family orientation. Solutions need to minimise equity-efficiency tradeoffs and to fit changing Asian conditions, for example rapid urbanization, increasing urban poverty, aging population, and a significant proportion of the population faces the risk of becoming poor due to the financial/economic crisis. The experience with social protection schemes after the Asian crisis has already provided some lessons. Thus, it is better to expand and modify if needed, established safety net programmes rather than to create new ones; it is important to protect pro-poor spending, not only on health and education, but also relevant infrastructure; self-targeted schemes (such as those based on work) are more effective than other attempts at targeting. There is a need for governments to prioritise social protection and pro-poor expenditures. In the 1990s many Asian governments attempted to protect social sector expenditure by cutting investment in rural development and this resulted in slower agricultural growth. But maintaining investment in agriculture and rural infrastructure can also be pro-poor. It is important to remember that social policy and social protection are not just welfare or redistributive measures; they are also critical parts of an overall development strategy and can contribute to macroeconomic stabilisation by providing automatic buffers against shocks, as well as to future growth by improving the potential for productivity increases.

The following principles should guide the design and implementation of social safety net instruments: (1) social safety nets should be in place before a crisis occurs since they can address the needs of the poor in good economic times and be adaptable to combat the effects of crisis; (2) pre-crisis planning is essential to effectively address the social effects of crises and includes the availability of reliable and timely information on the poor and frequent evaluation of safety net programmes; and (3) countries can select from a wide range of available instruments depending on their administrative capacity and target populations. Social safety nets have been designed with various objectives. Depending on these objectives they can be classified into income transfers through cash, food related transfer programmes, prices subsidies, human capital related social safety nets, public works programmes, and micro credit and informal insurance programmes.

Conditional Cash Transfers

Conditional Cash Tranfers (CCT) programmes are a new and innovative approach to basic social assistance. They provide money to poor families contingent upon certain behaviour changes, such as sending children to school or bringing them to health centres on a

regular basis. Cash transfer programmes could be based on employment generation or a universal programme that transfers some income to poor households, which can be used to spend on basic needs. Cash transfer programmes could be used for emergency purposes in periods of crisis or could be used as short- or medium term poverty alleviation programme. Almost all CCTs have tried to target their benefits rather narrowly to the poor through a combination of geographic and household targeting (mostly via proxy means testing). Moreover, many programmes use community-based targeting or community vetting of eligibility lists to increase transparency. CCTs are proven versatile programmes, which largely explain why they have become so popular worldwide. Virtually every country in Latin America has such a programme. The largest CCTs, such as Brazil's Bolsa Família and Mexico's Oportunidades (initially called as PROGRESA) cover millions of households. (Both these cases are iconic cases of CCTs).

In Asia, CCTs have been used to reduce gender disparities in education—some only secondary (Bangladesh's Female Secondary School Assistance Programme [FSSAP], Cambodia's Japan Fund for Poverty Reduction [JFPR], and Cambodia Education Sector Support Project [CESSP]), and occasionally both (Indonesia's Jaring Pengamanan Sosial [JPS] programme). The genesis of these programmes is rather varied. In Bangladesh, the FSSAP was part of a strategy to close the gender gap in education. In Indonesia, the JPS programme was instituted following the Asian financial crisis to prevent students from dropping out. Recent CCT pilot programmes or proposed programmes in India, Philippines and Pakistan also focused on education.

CCTs generally have been successful in reducing poverty and encouraging parents to invest in the health and education of their children. CCTs, by and large, have increased consumption levels among the poor. As a result, they have resulted in sometimes substantial reductions in poverty among beneficiaries—especially when the transfer has been generous, well targeted, and structured in a way that does not discourage recipients from taking other actions to escape poverty. In many countries, school enrolment has increased among CCT beneficiaries—especially among the poorest children, whose enrolment rates at the outset were the lowest. CCT beneficiaries also are more likely to have visited health providers for preventive checkups, to have had their children weighed and measured, and to have completed a schedule of immunizations. These are important accomplishments. This is why CCT programmes are increasingly perceived as being "a magic bullet in development." However, like all so-called magic bullets, they should not be overestimated.

CCTs vary a great deal in scope. Some programmes are nationwide, others are niche programmes that serve a regional or narrow target population, and yet others are small-scale pilot efforts. In terms of absolute coverage, they range from 11 million families (Brazil) to pilot programmes with a few thousand families. In terms of relative coverage, they range from approximately 40 % of the population (Ecuador) to about 20 % (Brazil, Mexico) to 1 % (Cambodia). Even if a country can afford a CCT programme, it is sometimes

argued that, relative to other types of social safety nets, they are expensive to operate. Closer scrutiny, however, shows a different picture. The costs range from about 0.50 % of gross domestic product (GDP) in such countries as Brazil, Ecuador, and Mexico to 0.08 % of GDP (Chile). The generosity of benefits ranges from 20 % of mean household consumption in Mexico, to 4 % in Honduras, and to even less for programmes in Bangladesh, Cambodia, and Pakistan.

National Rural Employment Guarantee Scheme

The National Rural Employment Guarantee Scheme (NREGS) in India, which is a demand-driven scheme based on a legal guarantee for employment NREGS, was launched on February 2, 2006, driven by a law passed in the previous year. It represents a major expansion in India's spending on public works and a shift to a rights-based approach to public employment provision. Under the scheme, every rural household is guaranteed up to 100 days of unskilled manual wage employment per year, at the statutory minimum wage for agricultural workers in the state. If employment is not provided within 15 days, the applicant is entitled to unemployment allowance. The scheme aims to provide work on labour-intensive projects focusing on rural infrastructure. A key feature is that the scheme is to be implemented through local governments, unlike earlier schemes that were implemented by the central or state governments. In the first phase, it covered 200 most backward districts; in the second phase, it has been expanded to 330 districts. Now it has been formally extended to all 596 rural districts in India with budgetary provision of around 0.6 % of GDP.

The scheme, which is still in it's early stages, has received mixed reviews so far but has been successful in some important ways. Thus far, the official records suggest that more than 30 million households have been provided some employment, and nearly 1.2 billion person days of employment have been generated. The enhanced wage earnings have led to a strengthening of the livelihood resource base of the rural poor in India, have reduced distress migration, and have become an extremely important buffer against both the employment shocks generated by the economic crisis (as migrant workers returned home to their villages) and against the drought that has swept across large parts of rural India in the summer of 2009. In the past two years, nearly 70 % of funds utilized were in the form of wages paid to labourers, and the scheme has been far more effective in generating work per rupee spent than earlier public works programmes. Self targeting in nature, the programme has significantly higher work participation of marginalised groups like Scheduled Castes (30 %), Scheduled Tribes (22 %), and women (52 %). Thus far, more than 2.3 million works have been undertaken, of around half were for water conservation, 15 % were for rural connectivity and 12 % were for land development. The Central Government has been encouraging the State Governments to make wage payment through bank and post office accounts of wage seekers, and nearly 50 million NREGA bank and post office accounts have been opened to disburse wages. The NREGA workers are also being encouraged to obtain insurance under Jan Shri Bima Yojana. (Data from NREGA website www.nrega.nic.in accessed on 20 September 2009.)

However, concerns about corruption have been raised. Also, implementation has been found to be highly variable across and within states and even districts. There have been implementation problems such as misuse of programme funds, ghost workers, and underpayment of wages. This is scarcely surprising, given the past experience with public spending in India, but the NREGA rules and guidelines do specify a greater degree of transparency and public accountability than in other schemes. Other concerns about the effectiveness of this spending have been raised. First, as with most workfare programmes, it is unclear how large the economic return from the projects undertaken (which are supposed to focus on roads and agricultural infrastructure) will be. Second, implementing such a large programme entails significant administrative burdens, and demands a level of efficiency and accountability that previous programmes have largely failed to achieve.

In principle, the NREGS could make a significant contribution to reducing rural unemployment and poverty. Research suggests that the lean season rural poverty rate could be reduced by 10–15 percentage points, with poorer households benefiting more than others. More fundamentally, the NREGS has the potential to transform rural economic and social relations at many levels. It is this capacity to engender change that is at once a source of strength and a weakness for the implementation of the programme. This is because it unleashes forces in the rural economy, society and polity which necessarily threaten the status quo and therefore also those who benefit from it, and so it is precisely where it is most needed that there is likely to be the most resistance to effective implementation. In fact, the huge potential of the NREGS has already been evident particularly in the enthusiastic response of local people, landless and marginal farmers and women workers in particular, wherever information about the programme has been properly disseminated.

But there is also no doubt that this enormous potential is still incipient and requires to be substantially supported in many different ways. This is because the way that the NREGA has been framed, and the desired mode of implementation, amount to no less than asking for a social and political revolution. The programme reverses the way the Indian state has traditionally dealt with the citizenry, and envisages a complete change in the manner of interaction of the state, the local power elites and the local working classes in rural India. The NREGS is therefore completely different in conception from earlier government employment schemes since it treats employment as a right and the programme is intended to be demand-driven. Furthermore, the Act and Guidelines anticipate very substantial participation of the local people in the planning and monitoring of the specific schemes, to a degree which has not been at all common. The very notion of employment as a right of citizens (even if it is limited to 100 days per household in the Act); of the obligation of the government to meet the demand for work within a specified time period, and to have developed a shelf of public works that can be drawn upon to meet this demand; of the local elected government participation in planning and monitoring; and the provision for social audit, are all very new concepts.

For this to work, it requires, at the minimum, two things: the ability and willingness of the local government and locally elected governments to plan works and run the programme effectively; and the dissemination about the programme and its guidelines to local people who can make use of it to register, demand work and run social audits. It should be evident that neither of these is very easy to attain, especially very quickly, and they require both much more capacity building and administrative support at local government levels, as well as significant mobilisation among the people who may be workers under the scheme.

Obviously, all this will take time to permeate down to the local levels. So to start with, it is only to be expected that there will be an uneven record of implementation as well as the presence of a large number of problems that require correction. There are bound to be difficulties and time lags in making local officials and others responsive to this very different approach. And of course, the NREGS necessarily challenges the prevailing power structures, in some cases quite substantially. Therefore attempts to oppose or subvert the correct and full implementation of the scheme in rural areas are only to be expected. Nevertheless, the extent to which the scheme is being implemented with even partial success in many parts of the country, including some very backward pockets, is already a source of optimism. Close monitoring and evaluation, as well as greater social mobilisation, will all be critical to ensure the programme's success. It is affecting the labour market in some parts of the country quite significantly. It has raised the

reservation wage by 10-15% in some areas and changed seasonal migration patterns to some extent. For example, the surplus agricultural region of Punjab is getting much less labour from Bihar and is shifting to greater mechanisation as more and more labour stays back in rural Bihar during the lean season. Similarly large construction projects across India are finding that costs of migrant labour have increased because rural workers are more able to find some gainful employment during the lean season. These trends may actually be seen as positive in terms of contributing to a wage-led recovery especially in rural India. More recently some people have accused NREGS of stoking inflation because it injects more purchasing power in rural areas but with no corresponding improvement in productivity, but it should be noted that the type of works that are typically undertaken (such as minor irrigation and water harvesting, soil improvement, etc.) are likely to improve land productivity with a lag, while other activities such as road building improve rural infrastructure and therefore supply and transport linkages.

Food-for-Work Programmes

The economic rationale for the food-for-fork programme, which uses food as a wage good in attracting labour for implementing the public works programme, comes from surplus and ready availability of food in rural areas that can be purchased by the implementing agency and cost effectively distributed by the public works programme. However, if the programme is not properly designed it can attract a wide range of beneficiaries who may not be entitled to food. Yet, the quality of food provided through the public works programme as wage may be better than the quality of food available in the open market. However, the food-for-work programmes can target the beneficiaries effectively by providing geographical targeting approaches and attracting labourers during the lean season of crop cultivation and by providing low quality food as wage so that only labourers in real need of food will participate in the programme.

Food security

The evident and growing problems of food insecurity in the region were noted in Chapter 5 of this study, and these problems have been compounded by the recent rise in food prices in most countries. It is therefore not surprising that many existing safety net programmes in Asia use food distribution as a mechanism to transfer resources to poor and vulnerable sections of society. It is evident that genuine food security among a population requires a wide range of features all or many of which are associated with the need for some public intervention. Ensuring adequate supplies of food requires increases in agricultural productivity, possibly changes in cropping patterns, and certainly the sustained viability of cultivation, all of would be necessary at both local and national levels. Making sure that food can be accessed by all the people requires that they have the purchasing power to buy the necessary food, which in turn means that employment, remuneration and livelihood issues are important. Social discrimination and exclusion still play unfortunately large roles in determining both livelihood and access to food by different social categories, and this too needs to be reckoned with. Malnourishment is closely linked to poor sanitation and other unhealthy practices, so that the provision of clean drinking water, sanitation and access to other basic amenities, as well as knowledge about correct or desirable eating habits, are all necessary. It is important for governments to be aware of the need for a multi-pronged approach to the problem that has to extend beyond food distribution to its production and patterns of consumption, so as to eventually ensure genuine food security.

Several challenges confront food distribution programmes. One of the most obvious is the difficulty inherent in targeting the most deserving or hungry sections of the population. There are many reasons

The surplus agricultural region of Punjab is getting much less labour from Bihar and is shifting to greater mechanisation as more and more labour stays back in rural Bihar during the lean season.

Programmes of public food distribution, across societies, have been those that have gone in for universal or near universal access. This provides economies of scale; it reduces the transaction costs and administrative hassles involved in ascertaining the target group and making sure it reaches them; it allows for better public provision because even the better-off groups with more political voice have a stake in making sure it works well; it generates greater stability in government plans for ensuring food production and procurement.

why targeted schemes are unlikely to work. There are the well known errors inherent in targeting, of unjustified exclusion of the genuinely poor and unwarranted inclusion of the non-poor. These are not simply mistakes that can occur in any administrative scheme, they are inbuilt into systems that try to provide scarce goods to one section of any population. In hierarchical and discriminatory societies, where social and economic power is unequally distributed, it is often the case that making a scarce good (cheap food) supposedly available only to the poor is one of the easiest ways to reduce their access. Further, there tend to be substantial differences between food insecurity and income poverty. In India, for example, the proportion of the population that is nutritionally deprived is significantly larger than the "poor" population, and the two are not completely overlapping categories either. To deal with food insecurity in an effective manner, it is counterproductive to base public food provision on a predefined group of the "poor", which would deprive a large number of others who are also food-insecure. Part of the reason for this relates to the third problem, the absence of any notion of dynamics in a rigid law that defines "poor" and "vulnerable" households in a static sense and changes the group only at infrequent intervals. Households – and people within them – can fall in or out of poverty, however defined, because of changing material circumstances. Similarly they can also go from being food-secure to food-insecure in a short time. The reasons can vary: crop failures, sharp rises in the price of food, employment collapses, health issues that divert household spending, the accumulation of debt, and so on. Monitoring each and every household on a regular basis to check whether any of these or other features has caused it to become food-insecure is not just administratively difficult, it is actually impossible.

This is why most successful programmes of public food distribution, across societies, have been those that have gone in for universal or near universal access. This provides economies of scale; it reduces the transaction costs and administrative hassles involved in ascertaining the target group and making sure it reaches them; it allows for better public provision because even the better off groups with more political voice have a stake in making sure it works well; it generates greater stability in government plans for ensuring food production and procurement. However, universal schemes are obviously more expensive overall and may be difficult to afford by governments that are already in fiscal difficulties.

Health Insurance

Countries such as China, Indonesia and Thailand are experimenting with multiple approaches to expanding health coverage. One model that seems to be working is Thailand's universal coverage "30 baht' scheme, which has sharply increased health utilization rates among the poor while reducing out of pocket spending. The success was made possible through prior investments in health care infrastructure (for example, every rural sub-district has a staffed health centre).

Old Age Security

The political demand for effective pension coverage is likely to grow as population aging proceeds. Well managed and regulated pension funds can help fill this gap, contribute to the development of capital markets and indirectly help sustain growth rates needed to keep up with a historically unprecedented aging process. Expansion to the informal sector needs to be done in a measured way, for example through voluntary participation in well regulated defined contribution schemes, as recently proposed in India, Thailand and Vietnam.

In selecting the appropriate instruments, governments should ensure that the measures: (i) provide adequate protection to the poor; (ii) promote efficient targeting; (iii) avoid creating a culture of dependency among recipients by limiting the size and

duration of benefits; (iv) are consistent with economic incentives and overall targets of fiscal and macroeconomic policy; and (v) encourage transparency and accountability in the design and implementation of programmes and in the use of resources.

Can Asia afford social protection?

Developing Asia spends less as a share of GDP on social protection than other regions. In many countries the main social safety net is via product subsidies (e.g. on fuel and rice), and is often fragmented among many schemes. In India and Thailand, for example, a multiplicity of small schemes each reaches only a small number of beneficiaries, providing meagre benefits and leaving gaps and unmet needs. Countries can therefore make some headway by consolidating multiple schemes into a more coherent programme. There is also significant scope for moving from product subsidies to more targeted and equitable cash transfer schemes. For instance, Indonesia and Egypt spent 5 % of their gross domestic product (GDP) in 2005 and 8 % of GDP in 2004 on energy subsidies. Another example is the bailouts of insolvent contributory pension funds. In Brazil, the government spends 3.7 % of GDP to cover the deficit in the main federal pension programmes, which deliver more than 50 % of their benefits to the richest 20 % of the population. On the other hand, Brazil's Bolsa Familia, covering the poorest 20 % of the population, cost about 0.4 % of GDP in 2007, which is only one tenth of the federal pension programmes. During the initial period of implementation, CCT programmes can be quite expensive to administer. Much of the budget is spent on undertaking targeting of transfers and monitoring the recipients' actions. However, administrative costs will spread over the implementation of the programmes, and their ratio to total transfers will fall rapidly over the years.

Public spending on social protection varies substantially in Asia-Pacific – both in terms of per capita and as % of GDP (Chart 19).

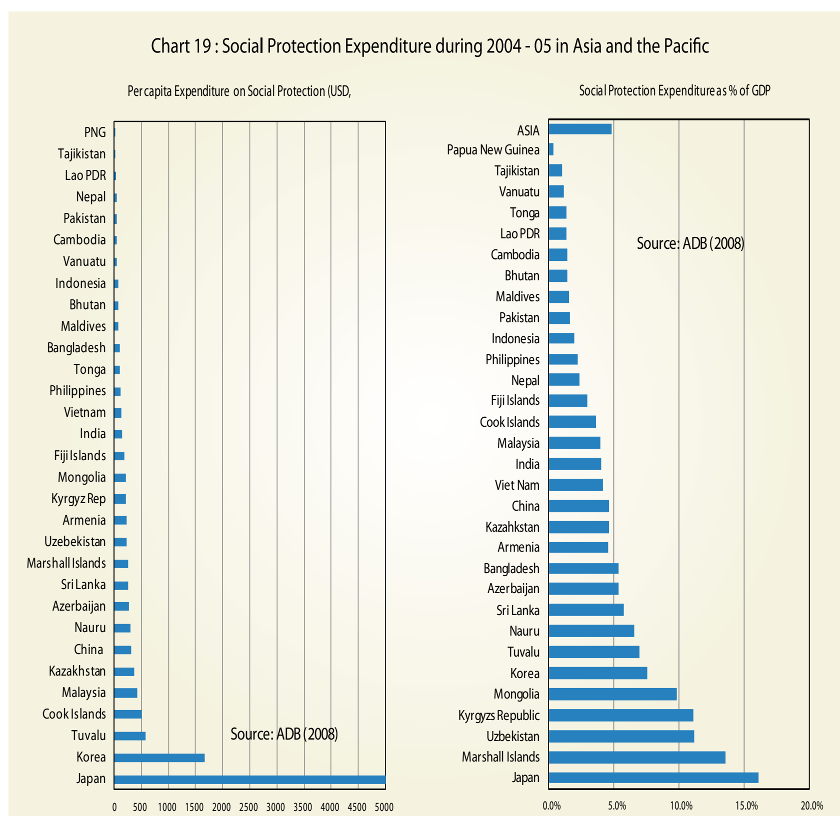


Chart 19 : Social Protection Expenditure during 2004 - 05 in Asia and the Pacific

Recent country experiences support this notion of maintaining or increasing social spending during crises. Spending on social protection programmes in Korea and Thailand rose by 1 percentage point of GDP and by almost 4 percentage points in Indonesia during 1998-99. The increased spending was achieved by relaxing the initial fiscal targets in response to the assessments of the social impacts of the crisis as well as the increase in financial support made available by international financial institutions.

7.6. Policies for sustained and equitable future growth

The previous discussion suggests that the crisis can be treated as an opportunity to redirect growth in Asia towards more equitable and sustainable trajectories, leading to more democratic outcomes. Six broad areas of public intervention create an agenda for a new Asian century in which the legitimate aspirations of the majority of Asian citizens can be met:

1. Rebalance Asian growth, from a focus on export-led to more regional and domestic demand expansion.

2. Make the economic growth process more inclusive and employment intensive: direct resources to the sectors in which the poor work (such as agriculture and informal activities), areas in which they live (relatively backward regions), factors of production which they possess (unskilled labour) and outputs which they consume (such as food).

3. Re-orient growth in Asia in cleaner and greener directions: shift from carbon-based (coal and oil) growth to solar, nuclear and renewable energy; emphasise cleaner transport systems and better urban planning and management, protecting and nurturing the regions' dwindling water and other natural resources, and mitigating the effects and adapting to the possibilities of climate change-induced natural disasters.

4. Provide much better social protection, with more funding, wider coverage and consolidation, more health spending and more robust and extensive social insurance programmes including pensions and unemployment insurance.

5. Improve financial sector performance while ensuring financial stability, by emphasising financial inclusion and deepening.

6. Expand Asian trade integration and monetary and financial co-ordination.

To conclude, this study has provided a broad summary of the impacts as well as challenges Asia has faced in dealing with the global financial/economic crisis and the preceding fuel and food price shocks. It has shown that the initially Asia was affected severely from the crisis. Trade and financial flows collapsed in almost all countries. Output contracted more severely in many Asian economies than even those nations at the epicentre of the crisis. But starting from the mid-2009, the region is recovering fast. Since the rest of global economy is expected to recover only slowly, unlike the Asian crisis in late 1990s, this time Asia cannot rely on an export-led recovery. Moreover, the export led growth strategy followed in much of Asia created its own limitations as it led to rising inequality, huge savings and lowered investment rates. The resulting surpluses were translated into massive accumulation of reserves and a perverse effect of transferring these to the developed world as Asia's weak financial systems were unable to transfer these funds into investment. Instead they fuelled overconsumption in the US but which was eventually unsustainable. Weak regulatory systems and an accommodating monetary policy in the US and Europe allowed the resulting bubble to become bigger and bigger and eventually burst, sending the world economy into a huge crisis which is still unwinding.

As the world now sits on a knife-edge it is an opportunity to rethink where Asia is headed. Going back to the growth model of the last two

decades is tempting to some as they feel it brought Asia the dynamic momentum for rapid growth and signs of prosperity. Asia re-emerged from almost two centuries of gloom and decline and began to emerge as a major growth centre in the world economy. But as we have shown in this paper the crisis is also an opportunity for many countries in Asia to re-orient their growth and development strategy. Asia cannot simply reset to 2007 and continue on the same path even if it wanted to because the global imbalances created by that growth strategy cannot continue.

The looming threat of global warming (and associated natural disasters) provides another major impetus to rethink and rebase Asia's growth model. Asia must grow rapidly in order to provide a better life to the millions of poor people but it must also do so with a much lower carbon trajectory. The witnessed was a warning of the impending climate change crisis because it signalled that the resources needed to maintain that growth path were too difficult to handle. In all of this Asia stands to lose if it does not change as it still has the largest number of poor people in the world who can ill afford even a small reduction in their incomes. For Asia the need to change is a matter not just of jobs and fiscal balances it is a matter of sheer survival. The stakes are too high not to make the change to a green and more inclusive growth model.

In addition to facing a series of global crises (food, fuel and financial crises) in the last two years, Asia also witnessed a series of natural disasters starting from Asian tsunami in December 2004 to a more recent (September/October 2009) earthquake/tsunami/floods in India, Indonesia, Philippines, Samoa, Tonga and Vietnam. Though the macroeconomic impact of these natural disasters are not generally severe as in the case of global crises, the human development impact in terms of dislocations, loss of lives and property damage) seem to be severe.

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Annex 1

Summary of fiscal stimulus packages in selected Asian Economies

Country	Amount	Proposed initiatives	Date Announced
China	Fiscal expenditure (CNY 4 trillion, USD 585 billion 13% of GDP),	Low income housing (280 billion) Improving rural living standards (370 billion) Healthcare, education (40 billion) Ecological and environmental protection (350 billion) Post-disaster reconstruction (1 trillion) Technological innovation (160 billion) Infrastructure construction (railways, highways, airports,power grids) (1.8 trillion)	9 Nov 2008
	Expedited spending of planned projects (CNY 600 billion)	Expedited investment spending on scientific and technical innovation/ upgrades	12 Jan 2009
	Fiscal expenditure (CNY 850 billion)	Healthcare reform to provide basic medical security to everyone; improve the quality of medical services; and make medical services more accessible	21 Jan 2009
Korea Rep	Fiscal expenditure and tax cuts under "2009 Budget and Public Fund Operations Plan to Overcome Economic Difficulties" (KRW 35.6 trillion, USD 26 billion, 4% of GDP)	Creation of more jobs by providing better job training through expansion of the internship system, vitalizing venture enterprises, increased job positions for the underprivileged Increase welfare support to stabilize livelihoods of low income classes and provide aggressive support in reducing childcare costs. Increase social overhead capital investment with focus on investments in construction projects including leading projects for advancement of the metropolitan economy and provincial traffic network expansion. Support stabilization of SMEs and the financial markets by increasing SME guarantees. Support regional finances to offset reduced real estate tax.	13 Dec 2008
	Fiscal expenditure under "Green New Deal Job Creation Plan" Measure expected to generate 950,000 jobs over 4 years (consolidation of previous plans) (KRW 50 trillion, USD 37 billion)	Energy conservation, recycling and clean energy development to build an energy-saving economy. Green transportation networks and clean water supplies to upgrade the quality of life and environment. Carbon reduction and stable supply of water resources to protect the earth and future generations. Building of industrial and information infrastructure and technology development to use energy efficient in the future.	Jan 2009
	Fiscal expenditure (supplementary budget bill) KRW 29 trillion	Maintaining job security and revitalizing provincial economies & supporting industries with future growth potential (17 trillion Won) Remaining amounts to plug tax revenue shortfalls	23 Mar 2009

Country	Amount	Proposed initiatives	Date Announced
India	Increase in planned expenditure and tax cuts (INR 200 billion) plus amount provided in the budget for 2008 but mostly unspent (INR 2800 billion) (Total INR 3000 billion, USD 60 billion)	Support to exports, textile sector, infrastructure, housing and SMEs. Increase expenditure on public projects to create employment and public assets. Petrol and diesel prices cut by Rs 5 and 3 per litre respectively. Interest rate cuts on loans for infrastructure and exports. Cut of 4% in excise duties across the board on all manufactured goods (except petroleum products)	7 Dec 2008
	Package to help realty and infrastructure sector	India Infrastructure Finance Company Limited permitted to raise funds to provide refinancing to public sector banks in the infrastructure sector. External Commercial Borrowings policy liberalized to increase lending to borrowers in the infrastructure sector. Countervailing duty and special countervailing duty reimposed on cement imports.	2 Jan 2009
	Tax cuts	Service tax cut across the board from 12% to 10% Excise duty reduced by 2% for items currently attracting 10%	25 Feb 2009
Thailand	Supplementary Budget (THB 116.7 billion, USD 3.3 billion, 1.2% of GDP)	One time living cost allowance of THB 2000 for those earning < THB 15,000 per month. Extension of 5 public service subsidies programme for 6 months. Support given to unemployed workers Free education for students. "Sufficient Economy Fund for Improvement in Quality of Life" fund for rural villages. Old-age support payment of THB 500 per month Infrastructure projects. Tax measures to boost real estate sector, SMEs and the tourism industry.	Jan 2009
	Thai Khem Khang (THB 1.43 trillion,USD 42 billion)(2010-2012)	Infrastructure investment in mass transit; transportation and communication; energy; education; healthcare; housing; water resources	June 2009
Malaysia	Fiscal expenditure (MYR 7 billion, USD 1.9 billion 1% of GDP)	Investment funds to promote strategic industries and high-speed broadband (1.9 billion) Small-scale infrastructure projects (1.6 billion) Education and skills training programmes (1 billion) Public transport and military facilities (1 billion)	Nov 2008
	Fiscal expenditure(MYR 60 billion,USD 16.2 billion 9% of GDP)	Fiscal injection (15 billion) Equity investment (10 billion) Tax incentives (3 billion) Guarantee funds (25 billion) Private finance initiatives and off-budget projects (7billion)	Mar 2009

Country	Amount	Proposed initiatives	Date Announced
Philippines	Fiscal expenditure and tax cuts (PHP 330 billion, USD 6.5 billion,4.6% of GDP)	Job creation programme expected to provide 824,000 temporary jobs at government departments by July 2009. Tax reduction in corporate income tax and waiver of personal income tax for minimum wage earners. Infrastructure projects Waiver of penalties on loans from social security institutions.	Jan 2009
Bangladesh	Fiscal expenditure (Taka 34240 million or USD 500 million, 0.6% of GDP)	Expenditure on cash subsidies to exporters (Tk. 4,500 million) Expenditure on agriculture (Tk. 15,000 million) Expenditure on power sector (Tk. 6,000 million) Expenditure on agriculture loans (Tk. 5,000 million) Expenditure on social security (Tk. 3,740 million)	April 2009
Vietnam	Fiscal expenditure (VND 17 trillion, USD 1 billion, 1.1% of GDP)	4% interest subsidy on loans to SMEs Reduction in corporate income tax for SMEs Exemption on personal income tax from Jan to May 2009	Dec 2008
	Fiscal expenditure (VND 300 trillion, USD 17.6 billion, 21% of GDP)	Infrastructure projects Measures to support manufacturing and export sectors Projects designed to support social security and welfare	March 2009
Indonesia	Fiscal expenditure and tax cuts (IDR 73.3 trillion; USD 6.1 billion 1.2% of GDP)	Tax breaks for individuals and companies (43 trillion) Waived import duties and taxes (13.3 trillion) Infrastructure spending (12.2 trillion) Diesel subsidy (2.8 trillion) Rural development (0.6 trillion)	Jan 2009
Sri Lanka	Package to support export sectors (LKR 16 billion USD 141 million; 0.3% GDP)	Incentives for the agricultural and industrial export sectors (tea, textiles, tourism, leather, rubber). Reduction in fuel prices Waiver on 15% electricity surcharge	30 Dec 2008

Source: ESCAP 2009, Official government web-sites, EIU Country Reports, various news sources

Annex 2

Comparison of current crisis with Asian crisis of 1997-98

Thailand

Indicator	Asian Financial Crisis			Current Crisis		
	Pre-crisis period	Crisis period	Recovery period	Pre-crisis period	Crisis period	
	94-96	97-99	2000-04	2005-07	2008	2009
Policy variables						
Budget balance (% of GDP)	2.3	-2.4	-1.5	-0.3	-1.1	-5.6
Current account balance (% of GDP)	-7.2	7.0	4.1	0.8	0.0	5.2
Foreign-exchange reserves(bil USD)	34.3	29.7	38.4	67.1	108.7	122.9
Import cover (months)	5.6	6.4	5.8	5.5	6.5	10.2
Short term debt (bil USD)	40.3	30.3	12.5	18.3	23.4	16.5
Stock market index	1155.1	403.5	474.0	750.6	450.0	n.a.
Exchange rate LCU:US$ (av)-THB/USD	25.1	36.8	41.8	37.5	33.3	34.5
Economic						
GDP (% real change pa)	8.0	-2.5	5.1	4.9	2.6	-4.5
Consumer prices (% change pa; av)	5.6	4.7	1.6	3.8	5.5	-1.0
Exports of G&S (% real change pa)	8.1	8.2	8.4	6.8	5.4	-16.2
Imports of G&S (% real change pa)	11.3	-7.5	11.4	5.2	7.5	-26.3
Trade balance (% of GDP)	-4.2	9.0	7.7	6.3	6.6	10.2
Social/MDG						
Poverty	9.8	13.6	12.0			
Enrolment Primary				93.9		
Enrolment Secondary				71.0		
GINI	43.4		42.0	42.5		

Source: Prepared by UNDP staff based on several sources

Philippines

Indicator	Asian Financial Crisis			Current Crisis		
	Pre-crisis period	Crisis period	Recovery period	Pre-crisis period	Crisis period	
	94-96	97-99	00-04	2005-07	2008	2009
Policy variables						
Budget balance (% of GDP)	0.9	-1.8	-4.4	-1.3	-0.9	-3.1
Current account balance (% of GDP)	-4.6	-2.2	-0.7	3.8	2.5	4.5
Foreign-exchange reserves(bil USD)	7.5	9.9	13.3	22.1	33.2	35.1
Import cover (months)	3.2	3.1	4.1	5.0	6.5	8.7
Short term debt (bil USD)	6.3	7.5	5.7	5.7	6.8	5.0
Stock market index	2850.2	1993.7	1389.2	2900.1	1872.9	n.a.
Exchange rate LCU:US$ (av)-PHP/USD	26.1	36.5	51.4	50.8	44.5	49.0
Economic						
GDP (% real change pa)	5.0	2.7	4.7	5.8	3.8	-1.0
Consumer prices (% change pa; av)	8.2	6.9	4.6	5.6	9.3	2.9
Exports of G&S (% real change pa)	15.7	-0.1	7.5	7.9	-1.9	-16.2
Imports of G&S (% real change pa)	15.8	-1.3	6.0	0.0	2.4	-17.0
Trade balance (% of GDP)	-12.7	-7.1	-7.5	-6.5	-7.5	-6.8
Social/MDG						
Poverty	28.1	21.6	22.5	22.6		
Enrolment Primary		91.9	93.18	92.4		
Enrolment Secondary		50.7	58.7	60.3		
GINI	46.2		46.1	44.0		

Source: Prepared by UNDP staff based on several sources

Malaysia

Indicator	Asian Financial Crisis			Current Crisis		
	Pre-crisis period	Crisis period	Recovery period	Pre-crisis period	Crisis period	
	94-96	97-99	00-04	2005-07	2008	2009
Policy variables						
Budget balance (% of GDP)	1.3	-0.9	-5.0	-3.4	-4.8	-8.0
Current account balance (% of GDP)	-6.7	7.7	9.7	15.4	15.6	14.1
Foreign-exchange reserves(bil USD)	25.4	25.6	40.2	84.3	91.1	88.0
Import cover (months)	3.8	4.0	4.8	6.8	5.9	8.8
Short term debt (bil USD)	8.2	9.8	8.0	12.9	10.0	5.0
Stock market index	1068.1	664.3	744.7	1147.0	876.8	n.a.
Exchange rate LCU:US$ (av)-MYR/USD	2.5	3.5	3.8	3.6	3.3	3.6
Economic						
GDP (% real change pa)	9.7	2.0	5.5	5.8	4.6	-5.0
Consumer prices (% change pa; av)	3.5	3.6	1.5	2.9	5.4	-0.3
Exports of G&S (% real change pa)	16.7	6.4	7.2	6.5	1.3	-25.3
Imports of G&S (% real change pa)	18.1	-0.8	9.3	7.7	1.9	-28.0
Trade balance (% of GDP)	1.9	18.8	21.1	22.5	19.8	18.6
Social/MDG						
Poverty(PPP)	2.1	2	2			
Enrolment Primary		97.7	96.8	97.5		
Enrolment Secondary		65.1	69.0	68.7		
GINI	48.5			37.9		

Source: Prepared by UNDP staff based on several sources

South Korea

Indicator	Asian Financial Crisis			Current Crisis		
	Pre-crisis period	Crisis period	Recovery period	Pre-crisis period	Crisis period	
	94-96	97-99	00-04	2005-07	2008	2009
Policy variables						
Budget balance (% of GDP)	2.4	1.6	1.4	1.5	1.2	-5.0
Current account balance (% of GDP)	-2.3	5.2	2.1	1.0	-0.7	3.2
Foreign-exchange reserves(bil USD)	30.8	48.8	134.9	237.1	201.1	235.8
Import cover (months)	2.5	4.3	7.7	7.7	4.6	7.2
Short term debt (bil USD)	56.4	48.8	49.1	113.3	151.1	114.8
Stock market index	853.8	655.6	706.5	1570.3	1124.5	n.a.
Exchange rate LCU:US$ (av)-KRW/USD	793.1	1180.5	1202.0	969.4	1102.0	1306.4
Economic						
GDP (% real change pa)	8.2	2.4	5.4	4.7	2.2	-1.8
Consumer prices (% change pa; av)	5.2	4.3	3.2	2.5	4.7	2.6
Exports of G&S (% real change pa)	17.6	16.3	12.4	10.6	5.7	-4.8
Imports of G&S (% real change pa)	19.5	3.2	10.5	10.2	3.7	-8.1
Trade balance (% of GDP)	-1.4	5.9	3.4	3.2	0.7	3.8
Poverty (PPP)		2				
Enrolment Primary		96.8	96.7	98.2		
Enrolment Secondary						
GINI						

Source: Prepared by UNDP staff based on several sources

Indonesia

Indicator	Asian Financial Crisis			Current Crisis		
	Pre-crisis period	Crisis period	Recovery period	Pre-crisis period	Crisis period	
	94-96	97-99	00-04	2005-07	2008	2009
Policy variables						
Budget balance (% of GDP)	1.3	-1.4	-1.5	-0.8	-1.9	-2.8
Current account balance (% of GDP)	-2.5	1.9	3.4	1.8	0.1	1.2
Foreign-exchange reserves(bil USD)	14.7	21.9	31.3	43.1	49.6	56.2
Import cover (months)	3.6	5.8	6.8	5.4	4.3	6.6
Short term debt (bil USD)	25.9	24.3	22.9	32.5	27.4	23.7
Stock market index	540.3	492.2	587.7	1904.5	1355.4	n.a.
Exchange rate LCU:US$ (av)- IDR/USD	2250.6	6926.1	9102.0	9335.0	9699.0	10496.9
Economic						
GDP (% real change pa)	7.9	-2.5	4.7	5.8	6.1	4.1
Consumer prices (% change pa; av)	8.6	28.4	8.0	10.0	9.9	4.4
Exports of G&S (% real change pa)	8.4	-4.2	9.0	11.5	9.5	-14.8
Imports of G&S (% real change pa)	16.0	-10.2	9.6	11.8	10.0	-21.3
Trade balance (% of GDP)	3.1	11.7	11.9	7.3	4.6	5.2
Social/MDG						
Poverty	17.5	27.1	16.7			
Enrolment Primary			97.9	97.7		
Enrolment Secondary			51.2	58.9		
GINI	31.2		29.9	34.5		

Source: Prepared by UNDP staff based on several sources