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Summary of the Economic and Social Survey of Asia and the Pacific 2012

Summary

The V-shaped recovery from the depths of the 2008-2009 global financial crisis in 2010 proved to be short-lived as the world economy entered the second stage of crisis in 2011, with a sharp deterioration in the global environment as a result of the accentuation of the eurozone debt crisis and the continued uncertain outlook for the economy of the United States of America. As forewarned in the *Economic and Social Survey of Asia and the Pacific 2011*, the growth rate of developing economies in the Asia-Pacific region declined substantially in 2011, with a further slowdown forecast in 2012, emanating from a slackening demand for the region's exports in advanced economies and higher costs of capital. As the region struggles to emerge from the crisis, of even greater concern are the serious and growing inequalities between and within countries in the region. Despite the slowdown, the region will continue to remain the fastest growing globally and an anchor of stability in the world economy. Many economies in the region continue to grapple with the challenge of inflation. With inflation remaining relatively high in some countries owing to domestic factors and with concerns about global commodity prices, the dilemma of maintaining price stability in the face of slackening growth resulting from the deteriorating global environment has not fully receded. Further injection of liquidity into the financial markets will heighten the risk of asset market bubbles and exchange rate appreciation. An increasing concern of policymakers in the region is the imposition of various trade restrictive measures by crisis-affected countries. A number of countries in the region have also been severely affected by the effects of natural disasters, which have significant regional implications. Despite the challenging global environment, the region remains in a relatively favourable situation in terms of protecting its economic dynamism owing to its strong macroeconomic fundamentals. If serious pressure on growth performance were to materialize, many countries would benefit from sufficient policy space to undertake supportive

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measures. The present report summarizes the analysis of the *Economic and Social Survey of Asia and the Pacific 2012* with regard to the current global turbulence and the outlook for the region for the year ahead. In addition, the 2012 *Survey* conducts an in-depth analysis of the long-term policy implications of high commodity prices.

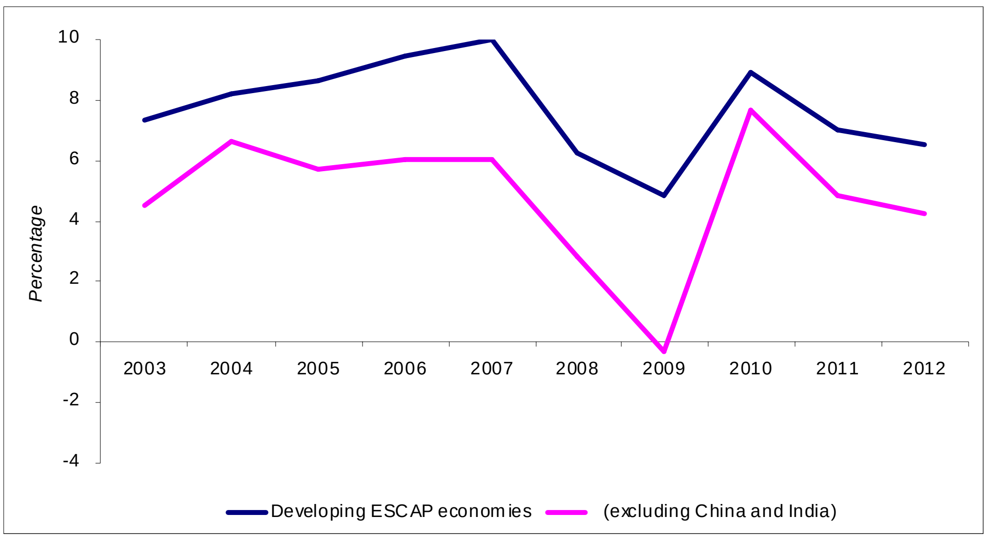
The Economic and Social Council may wish to deliberate on these issues and propose policy recommendations for promoting inclusive and sustainable development in the region.

I. Growth outlook for 2012

Second stage of the crisis

1. The V-shaped recovery from the depths of the 2008-2009 global financial crisis in 2010 proved to be short-lived as the world economy entered the second stage of crisis in 2011, with a sharp deterioration in the global environment as a result of the accentuation of the eurozone debt crisis and continued uncertain outlook for the economy of the United States of America. As forewarned in the *Economic and Social Survey of Asia and the Pacific 2011*, the growth rate of the developing economies in the Asia-Pacific region declined to 7.0 per cent in 2011 from a robust rate of 8.8 per cent achieved in 2010 (see figure I). The growth rate of the economies of the region is forecast to decline further to 6.4 per cent in 2012, with a slackening demand for the region's exports in advanced economies and because of higher costs of capital.

Figure I
Economic growth rates for developing economies in the Asia-Pacific region, 2006-2012



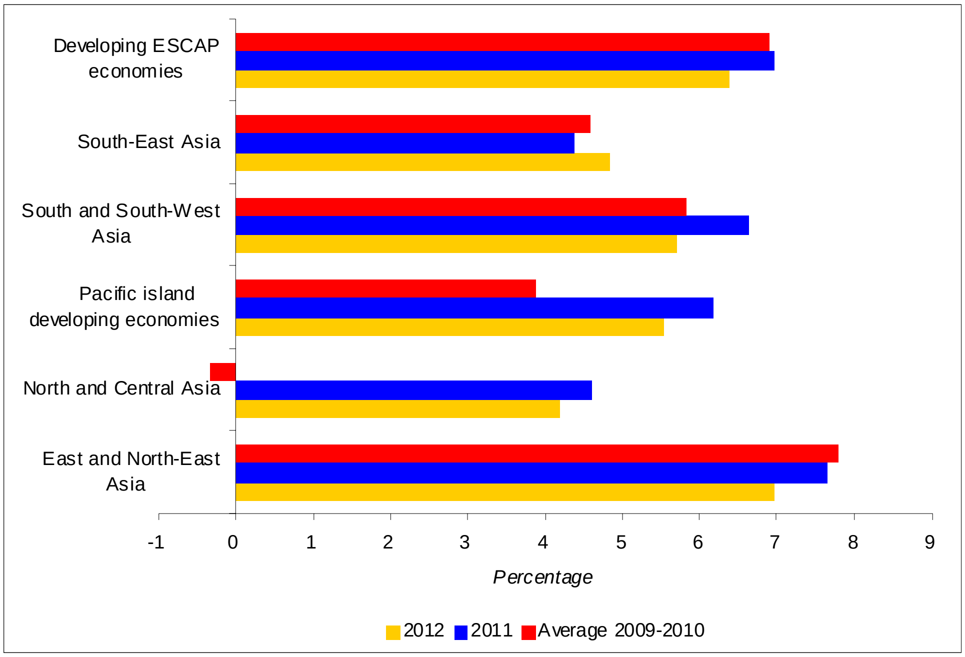
Source: Economic and Social Council for Asia and the Pacific (ESCAP).

2. The growth slowdown will be felt across different subregions depending upon the extent of their global integration. The growth rate in East and North-East Asia is forecast to slow down to 7.1 per cent in 2012 (from 7.6 per cent) (see figure II). North and Central Asia is forecast to experience a relatively moderate slowdown to 4.2 per cent in 2012, benefiting from the high prices for energy. The Pacific island developing economies are forecast to experience lower aggregate growth in 2012, of 5.5 per cent, owing mainly to lower growth in Papua New Guinea, although a number of other countries are likely to maintain a fairly stable performance. The South and South-West Asia subregion is forecast to see a slowdown to 5.8 per cent in 2012, from 6.5 per cent in 2011, although more on account of monetary tightening than the global slowdown. South-East Asia, while an open subregion with

many economies that are severely affected by the state of the global economy, is forecast to see a slight increase in growth in the subregion as a whole, to 4.6 per cent in 2012, owing to a strong recovery in growth in Thailand following the floods in 2011. With the slowdown in growth, inflation is forecast to moderate from 6.1 per cent in 2011 to 5.2 per cent in 2012 (see figure III).

Figure II

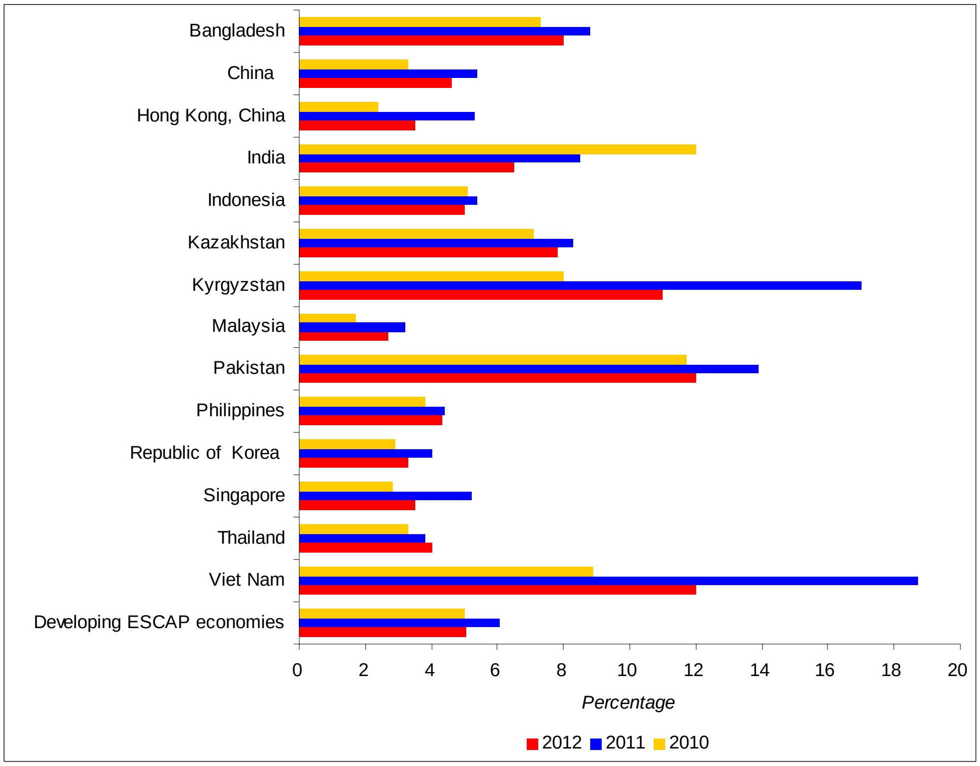
Real gross domestic product growth and forecasts of developing Asia-Pacific economies by subregion, 2009-2011



Sources: ESCAP, based on national sources; International Monetary Fund (IMF), International Financial Statistics databases (Washington, D.C., August 2011); Asian Development Bank (ADB), *Key Indicators for Asia and the Pacific 2011* (Manila, 2011); CEIC Data Company Limited and ESCAP estimates.

Notes: Rates of real gross domestic product (GDP) growth for 2011 are estimates; those for 2012 are forecasts (as at 1 March 2012). Asian and Pacific developing economies comprise 37 economies (excluding those in North and Central Asia). East and North-East Asia in the present figure excludes Japan. The calculations are based on the weighted average of GDP figures in United States dollars in 2010 (at 2000 prices).

Figure III
Consumer price inflation of selected developing economies in the ESCAP region, 2010-2012

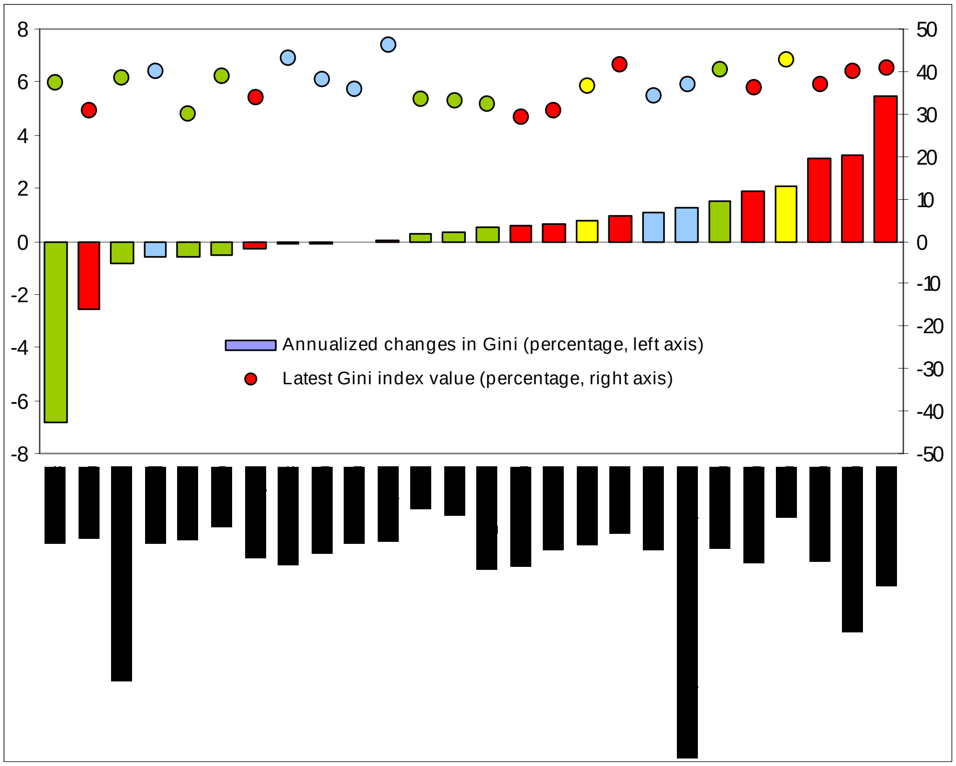


Sources: ESCAP, based on national sources; IMF, International Financial Statistics databases (Washington, D.C., August 2011); ADB, *Key Indicators for Asia and the Pacific 2011* (Manila, 2011); CEIC Data Company Limited and ESCAP estimates.

Notes: Rates of inflation for 2011 are estimates and those for 2012 are forecasts. Developing economies of the region comprise 37 economies (excluding the Central Asian countries) and the calculations are based on GDP figures at market prices in United States dollars in 2009 (at 2000 prices) used as weights to calculate the regional rates.

3. As the region continues to be affected by the crisis, of major concern is the serious and growing inequality in the region, in terms of both income and social progress. Income inequality in the developing countries of Asia and the Pacific has been rising at a worrying pace, increasing by 15 per cent between the 1990s and 2000s. In this period, income inequality rose in 16 out of 26 countries with available data, including in the major economies of the region such as China, India, Indonesia and the Russian Federation (see figure IV). Income inequality in the most serious case, Turkmenistan, increased at a compound annual rate of up to 4.4 per cent. Social progress in the region has been significantly constrained by the levels of inequality seen in countries. The achievement of the health and education aspects of human development, when adjusted for inequality, is considerably lower for many countries in the region. It is clear from these worrying trends that the growth model in the region has to be rebalanced through policies that propagate prosperity through empowering those who have been left behind.

Figure IV
Compound annual changes in Gini income coefficients and latest value for selected developing Asia-Pacific countries, 1990s-2000s



Source: ESCAP calculations based on the World Bank PovcalNet database.

4. Despite the slowdown, the region will continue to remain the fastest growing globally and an anchor of stability in the world economy. The growth engines in the region continue to grow at robust rates. China is likely to grow at a rate of 8.5 per cent in 2012, after decelerating from a rate of 9.2 per cent achieved in 2011. India is expected to improve its growth performance from 6.9 per cent to 7.5 per cent in 2012, as moderating inflation would allow unwinding of the cycle of monetary tightening during the current year, thus unleashing growth impulses. With its continued dynamism, the Asia-Pacific region has begun to play the role of a growth pole for other developing regions, namely, Latin America and Africa, helping them to reduce their dependence on low-growth developed economies as South-South trade becomes an important trend.

Downside risks

5. The above projections are subject to some important downside risks. The foremost risk being a scenario of disorderly sovereign debt default in Europe or the break-up of the euro common currency area that could lead to a renewed global financial crisis. ESCAP estimates that such a crisis could, in a worst case scenario, lead to a total export loss of $390 billion over the period 2012-2013. The countries that would suffer most would be those with special needs such as the least

developed countries and the landlocked developing countries, which depend heavily on advanced country markets and could see exports contract by 10 per cent. The loss of exports could lead to up to a 1.3 percentage point reduction in growth in 2012 and hamper poverty reduction in the Asia-Pacific region, such that by 2013 an additional 14 million people could be trapped below the $1.25-a-day poverty line, and 22 million below the $2-a-day poverty line.

6. The other risk relates to inflation and the volatility of oil prices. Many economies in the region continue to grapple with the challenge of inflation. Inflation, while moderating somewhat in recent months, still remains at elevated levels in many economies. Global food prices remain at close to record levels. Similarly, oil prices have moved up in recent months to levels not seen since the start of the crisis, owing to non-demand-related factors such as political instability in major oil producing countries. ESCAP estimates that if oil prices were to increase by $25 for an extended period from their already elevated levels, inflation in developing economies in the Asia-Pacific region would increase significantly by 1.3 percentage points. The inflation impact on poorer groups would be more marked, as they typically face a higher consumption-to-income ratio and swifter price increases. Current account balances and fiscal balances are also estimated to deteriorate, as most regional economies are net importers with extensive fuel price subsidies in several countries. A 25 per cent increase in diesel and gasoline price subsidies alone would push the Asia-Pacific fuel price subsidy bill up by $17 billion from the 2010 estimate.

7. The third risk relates to the effects of the measures likely to be adopted by developed economies in order to support their own growth. Further injection of liquidity to the financial markets as well as the interest rate differential with the Asia-Pacific region will result in the continuing attraction of asset markets and currencies in the region for foreign investors. This will heighten the risk of asset market bubbles, exchange rate appreciation and inflationary pressures. An increasing concern of policymakers in the region is the imposition of various trade restrictive measures by developed countries in recent months in an effort to protect their economies in a climate of slow growth. This may lead to escalation of a trade war, as the economies in the Asia-Pacific region may take retaliatory measures that would make the recovery of the world economy even more difficult. It is important to resist such protectionist tendencies and to conclude a successful Doha development round at the World Trade Organization and thereby encourage freer flows of trade.

8. On the positive side, the region retains the policy space to launch fiscal stimulus packages and lower policy rates to mitigate the worsening of the global economic environment, as discussed below.

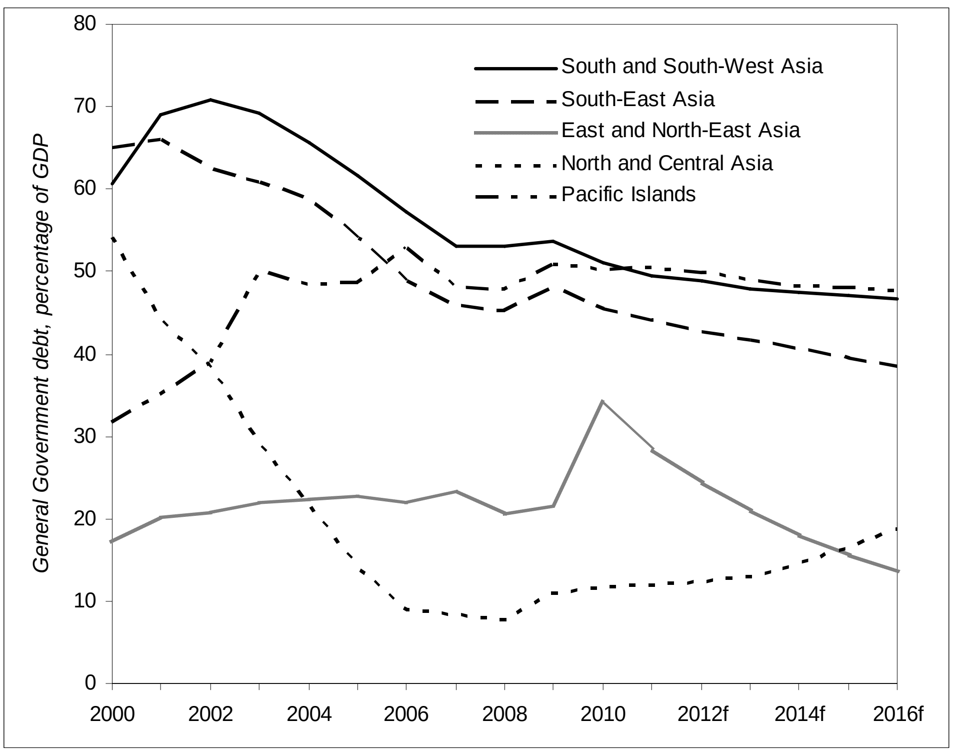
9. The blow of lower exports to developed countries could also be cushioned by greater intraregional trade. This is already growing faster than trade with the rest of the world: between 2000 and 2010, intraregional exports increased from 43 per cent to 50 per cent of total exports. However, a significant portion of these exports are intermediate goods, or commodities that principally go to China. It should be noted that, compared with advanced countries, the import content of consumption in China is quite low. For the exporters of manufactured goods in the region, India and Indonesia offer increasingly promising markets, although at present their consumers have less purchasing power than those in China. Similarly, intraregional flows have helped foreign direct investment (FDI) inflows to recover, with the growing importance of Asia-Pacific economies as sources of FDI.

II. Policy challenges and options

Managing the growth and inflation balance

10. Growth in many countries in the region will come under pressure in the difficult global climate. With relatively sound macroeconomic fundamentals and low public debt to GDP ratios, Asia-Pacific developing economies have considerable policy space to mount fiscal stimulus programmes and relax monetary policy to support growth. Relative to other regions, public indebtedness in Asia and the Pacific is not generally high. Indeed, between 2001 and 2008, Government debt-to-GDP ratios fell from 53 per cent to 34 per cent (see figure V). And despite fiscal stimulus during the turmoil of the period 2008-2009, the ratio over the period 2009-2011 was still only 38 per cent. Most economies thus have significant fiscal space. Some economies in the region, such as Malaysia and the Philippines, have already announced fiscal stimulus programmes in the second half of 2011 in response to the deteriorating economic situation. They also have the space to lower policy rates to relax monetary policy to stimulate the economies, and some economies, such as Indonesia and Thailand, lowered interest rates in the fourth quarter of 2011.

Figure V
Public debt for ESCAP subregions



Source: ESCAP calculations and IMF World Economic Outlook Database.
Note: The regional debt ratios are weighted means, based on a country’s GDP in corresponding years.

11. The concern, however, with the enactment of stimulus measures in the region is their impact on inflation. If inflation remains high despite slowing growth because of external factors, then further stimulus would increase inflation to uncomfortable levels in tandem with supporting growth. Inflation, while moderating somewhat in recent months, still remains at elevated levels in many economies. However, monetary policy to manage inflation is a blunt instrument, as it implies controlling external or supply-led price increases by restricting local demand. Governments will therefore need other inflation-fighting measures, such as reducing taxes or tariffs, along with restricting inflows of foreign capital. Nevertheless, in cases of substantial price increase, monetary policy may remain the most effective tool, though with significant growth implications. Policymakers thus need to find their preferred inflation-growth combination, as there clearly is a trade-off between tackling the one and fostering the other.

Coping with capital flows

12. Over the past few years, the region has also had a surge in short-term debt flows. Loose monetary policies in the developed countries could result in an even larger influx, as investors attempt to insulate themselves against risks in financial markets. Many countries in the region could thus face considerable exchange-rate volatility, which will complicate macroeconomic planning.

13. Economies in Asia and the Pacific have traditionally managed exchange-rate volatility by accumulating foreign exchange reserves. But these reserves are not necessarily adequate. Some countries have acknowledged this by arranging other sources of foreign exchange support, while also looking to global financial safety net arrangements through IMF, regional agreements such as the Chiang Mai Initiative, and bilateral currency swap arrangements such as the one signed by India and Japan in December 2011 for $15 billion.

14. In addition, given the disadvantages of dealing with capital flows by using reserves, economies in the region have increasingly turned to capital account management measures. Indonesia, the Republic of Korea and Thailand imposed such measures in 2010. However the continuing surge of volatile short-term capital to the region has made it necessary to consider further measures such as applying quantitative restrictions on short-term equity flows and bank non-productive investment lending to improve the quality of capital flows. ESCAP analysis shows that the overall stringency of measures may help to prevent extraordinarily high surges in inflows, although it highlights the need to tailor the instruments to the types of flows that the country is affected by. It is clear that economies in the Asia-Pacific region may have to design capital account management measures to deal with the ‘‘new normal’’ of pressure for the entry of short-term volatile capital into the region.

Addressing unemployment

15. The unemployment rate in Asia and the Pacific has fallen only slightly, from 4.3 per cent in 2010 to 4.2 per cent in 2011. The region continues to face the problem of jobless growth, with the developing Asian countries failing to generate sufficient opportunities in the formal sector. The problems are greatest for young

people, who are three times more likely to be unemployed than adults. The youth unemployment rate for the Asia-Pacific region is projected to remain at 10.2 per cent in 2012. Moreover, in 2010 some 1.1 billion workers in the region remained in vulnerable employment.

16. It is important to ensure that wages increase in line with better productivity gains. This would allow domestic consumption to act as an enhanced engine of growth and sustain a virtuous circle of improved productivity, better working conditions, reduced inequality and sustainable and inclusive development. Policy options should also be devised to boost entrepreneurship and rural employment and support green jobs. Such policies would help countries avoid falling into the "middle-income trap", in which productivity fails to keep pace with economic growth. A post-crisis macroeconomic framework should seek full employment for men and women as a core policy goal, besides economic growth targets, inflation and sustainable public finances. Improved social protection can support countries in their efforts to rebalance the sources of growth besides reducing income insecurity for the poor. The crisis has prompted some countries in the region, such as Malaysia and the Philippines, to consider establishing unemployment insurance schemes, while India has expanded its national rural employment guarantee scheme.

Dealing with disaster risks

17. In 2011, a number of countries were severely affected by natural disasters, starting with the earthquake in Christchurch, New Zealand, followed by the Tohoku earthquake and tsunami in Japan in 2011 and then severe flooding in a number of countries, notably Thailand and Pakistan.

18. Overall, the damages and losses for the Asia-Pacific region in 2011 were at least $267 billion. Critically, the disasters are leading to regional impacts given the growing interdependence of the region. For instance, the earthquake in Japan and floods in Thailand caused severe disruption in regional and global supply chains, particularly for industrial and manufacturing products. Moreover, severe floods in the Asia-Pacific region also resulted in production losses in the agricultural sector, leading to regional and global impacts on food production.

19. Countries across the region need to invest more in disaster risk reduction as an essential component of their long-term development strategies. This will involve protecting social and economic assets from floods and other disasters, particularly in those areas where rapid economic growth has heightened the risks. It will also be important to maintain and restore ecosystems that buffer the impact of natural hazards, while providing alternatives for those living in high-risk areas. At the same time, Governments will need to develop effective early warning systems along with plans for disaster management and recovery.

20. Because the causes and impacts of natural disasters cross national boundaries, it is also necessary to ensure international cooperation. For this purpose, Governments can take advantage of various regional cooperation frameworks, such as the ESCAP/World Meteorological Organization (WMO) Typhoon Committee, the Regional Integrated Multi-hazard Early Warning System (RIMES) and the WMO/ESCAP Panel on Tropical Cyclones. United Nations entities are also working with the Association of Southeast Asian Nations (ASEAN) to build resilience to natural disasters through the joint ASEAN-United Nations Strategic Plan of Cooperation on

Disaster Management (2011-2015), as well as the joint ASEAN-United Nations Mechanism for Rapid Response to Climate-related and Other Disasters.

The rebalancing challenge

21. The continued uncertain economic outlook for developed economies, coupled with the imperative of restraining debt-fuelled consumption as a part of unwinding global imbalances, means that a return to pre-crisis business-as-usual, where developed countries acted as growth engines for developing countries in Asia and the Pacific, would be highly unlikely. The Asia-Pacific region will have to gradually rebalance its economies in favour of domestic consumption and investment and deepening regional economic integration. An acceptable range of policies to continue the rebalancing of economies at a time of constrained growth is to implement a set of measures that supports future growth engines while not unduly affecting those of the present. These measures should include greater investment in infrastructure, which could be supported by a new regional financial architecture for development financing. Consumption by individual families could also be increased if they had less need for precautionary savings because Governments were providing greater security through stronger systems of social protection. These would include strengthening systems for pensions, health and unemployment insurance, for example, and spending more on health and education services. Another set of policies should be directed towards agriculture — to boost incomes in the rural areas that are home to the majority of the poor families in the region. Many countries would benefit from a knowledge-intensive second ‘‘green revolution’’ based on sustainable agriculture.

22. A third set of policies would be to support the development of the ‘‘green economy’’, which recognizes the important interlinkages between the environmental resource base, economic systems and social development and which focuses on the building blocks of sustainable development — from food and nutrition security to sustainable energy and universal access to safe drinking water and sanitation for all. To provide sufficient resources, a mix of public and private financing is needed. At the international level, measures to scale up financing for sustainable development should facilitate free or low-cost access to technology. These issues will receive particular attention in 2012 with the United Nations Conference on Sustainable Development, to be held in Brazil. Green economy policies are tools that can help to develop these synergies between economic growth and environmental sustainability.

23. Finally, an important key to rebalancing in the Asia-Pacific region is to exploit the potential of regional economic integration. While intraregional trade has expanded rapidly since 1998, reaching 54 per cent in 2008, the potential is even greater. The existing approaches towards exploiting the potential of intraregional trade in Asia and the Pacific have been primarily limited to numerous subregional and bilateral preferential trading arrangements. Because of different rules, scope and coverage, these preferential arrangements do not provide a seamless broader market of Asia and the Pacific. A broader pan-Asian integrated market may help in exploiting the complementarities between the subregions that ESCAP analysis has demonstrated to be substantial and often greater than those within the subregions. The agenda for exploiting regional economic integration also needs to pay attention to strengthening physical connectivity and people-to-people contacts through addressing the critical gaps in hard and soft infrastructure, as highlighted by ESCAP. The sixty-eighth

session of the Commission would offer an opportunity to provide an impetus to the agenda of regional economic integration in Asia and the Pacific.

Development-friendly global economic environment and governance

24. The Asia-Pacific region has a stake in the way the global economy is managed and governed, keeping in mind the fact that the growth outlook of the region is so critically affected by the global economic environment, as described above. The Asia-Pacific region should use its collective weight in the global forums such as the Group of Twenty (G20) summits, in which eight countries of the region are represented, or the summits of the BRIC countries (Brazil, Russian Federation, India and China), in which three countries of the ESCAP region are involved. First and foremost, the Asia-Pacific region has to draw the attention of the international community to the need to undertake reforms for reviving growth and job creation in the advanced countries. This should involve a credible medium-term programme of fiscal consolidation and the use of responsible macroeconomic policies to avoid the creation of excessive liquidity that leads to volatility in the emerging markets. Instead of volatile short-term capital, the developing economies of the Asia-Pacific region need a flow of long-term development finance for financing their widening deficits in infrastructure development. They should also seek a cease-and-desist moratorium on protectionist tendencies in developed countries.

25. The Asia-Pacific members of the G20 should also seek to ensure that the Group plays its role as a premier council for global economic cooperation to moderate the volatility of oil and food prices that are highly disruptive of the process of development. In the area of oil price volatility, the G20, including all major consumers as its members, can match the power exercised over the oil markets by the cartel of producers, namely, the Organization of Petroleum Exporting Countries (OPEC). ESCAP has proposed that OPEC and the G20 may demarcate a benchmark ‘‘fair’’ price of oil and agree to restrict the oil price movement within a band around it. An additional measure to moderate the volatility in the oil markets is for the G20 to create a global strategic reserve and releasing it countercyclically. Experience has shown that oil prices go down in past instances of the major developed economies drawing on their strategic reserves. In the case of food price volatility, the G20 may act to regulate speculative activity in food commodities and discipline the conversion of cereals into biofuels. It may expedite the implementation of the L’Aquila Joint Statement on Global Food Security, which included the provision of financing to developing countries for food security.

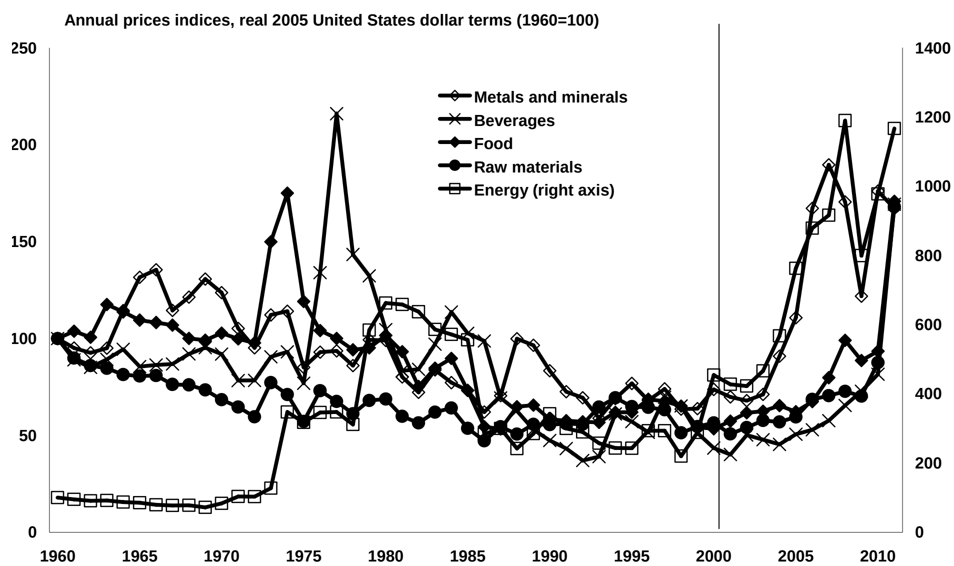
26. The region will also need to exert its influence for building a more development-friendly international financial architecture emerging through discussions in the G20. Important proposals outlined by ESCAP in this regard include: establishing a special drawing rights-based global reserve currency that could be issued countercyclically; a global tax on financial transactions to raise resources for achieving the Millennium Development Goals, besides moderating short-term capital flows; and international regulations to curb excessive risk-taking by the financial sector. The approach adopted by the G20 to address the global imbalances by restraining the current account imbalances to a certain percentage of GDP is a good start. In these and other areas, the Asia-Pacific region can further coordinate its actions, through its eight members in the G20, to ensure that the

global economic governance architecture meets the developmental needs of the region. The United Nations, given its global membership, should play a leading role in facilitating broad-based consultations on global issues, including by providing an outlet for non-G20 countries to communicate their views to the summit, as facilitated by ESCAP through its ongoing programme of high-level consultations on perspectives from Asia and the Pacific for the G20 summits.

III. Long-term effects of high commodity prices

27. Commodity price volatility has raised global concerns about inflation, hunger and poverty, but the longer-term rising commodity prices also threaten the growth trajectory of developing countries and could widen global disparities. Breaking the historical downward trend in prices, commodity markets have been experiencing a boom since 2000 (see figure VI), with average annual price growth rates ranging from 1.8 per cent for beverages to 17.4 per cent for metals and minerals.[1]

Figure VI
The new century was a turning point for commodity prices



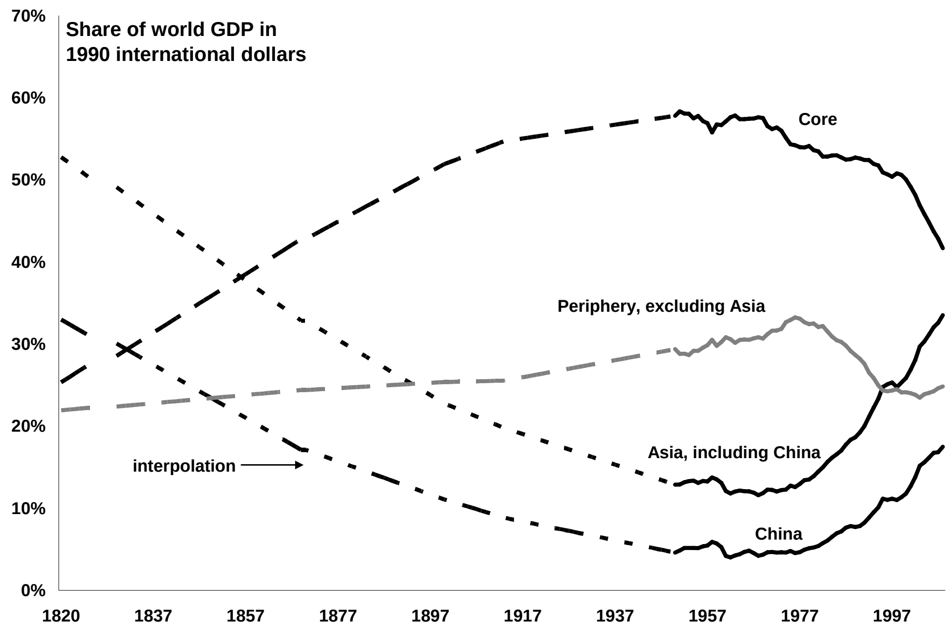
Source: ESCAP, based on data from World Bank, 2011 (accessed 5 April 2012).

28. Short-term price rises can be the result of many factors, but the longer-term increasing trend has fewer, and more basic, explanations. A factor contributing to rising prices is economic growth, which increases the demand for a broad range of primary products for production, trade and transport. The commodity boom during the past decade coincided with a period of very fast growth driven mainly by manufacturing in Asia, which has boosted the global demand for primary products and fuelled the economic growth of a number of low-income countries that depend heavily on commodity exports.

[1] ESCAP, based on data from World Bank, 2011a (accessed 27 September 2011).

29. A similar situation happened in the first period of globalization in the nineteenth century. The industrial revolution increased the demand for fuel, fibre and metals, causing prices of primary products to soar.[2] Echoing what had occurred 150 years earlier, in the late-1970s a group of countries, this time from Asia, started to become major global players. Between 1979 and 2008, these countries increased their share of global GDP from 13 to 33 per cent (see figure VII). The two principal growth engines over this period were China, whose share in global GDP increased from 5 to 17 per cent, and India, whose share increased from 3 to 7 per cent. Their fast growth drew in other Asian countries that were part of the supply chains of manufacturing production.

Figure VII
The rise of Asia, share of global GDP



Source: ESCAP.
Notes: ''Core'' corresponds to Western Europe (i.e., Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Sweden, Switzerland and the United Kingdom of Great Britain and Northern Ireland), its Western offshoots (i.e., Australia, New Zealand, Canada and the United States) and Japan. ''Asia'' corresponds to China, India, Indonesia (including Timor-Leste until 1999), the Philippines, the Republic of Korea, Thailand, Taiwan Province of China, Bangladesh, Myanmar, Hong Kong, China, Malaysia, Nepal, Pakistan, Singapore and Sri Lanka. ''Periphery'' corresponds to the world, excluding the ''core'' countries.

30. The boom in commodities has ended a secular decline in commodity terms of trade. Exporters of commodities are enjoying improvements in their terms of trade while many low-income, resource-scarce countries have endured the increase in the prices of imports and the reduction of the international prices of their manufacturing exports, resulting in diminishing terms of trade. The countries that experienced the

[2] Jeffrey G. Williamson, *Trade and Poverty: When the Third World Fell Behind* (Cambridge, Massachusetts, MIT Press, 2011).

highest increase in their terms of trade during the period 2000 to 2008 were all major exporters of energy resources or minerals. On the other hand, countries whose main exports are manufactures have seen their terms of trade deteriorate.

31. The impact of the commodity boom in the growth trajectory of these countries depends on the extent that price shifts for both manufactures and commodities has on altering incentives within each economy either towards or away from increasing diversification and modernization. During the industrial revolution, for example, the rich core countries that specialized in manufactures grew much faster than the poor periphery countries that specialized in primary products, which gave rise to the great income divergence between the rich and the poor periphery countries, much of which persists to this day. The same factors that have contributed to the increasing divergence during the nineteenth century are at play today. This time around the dynamics are more complex because there are not two groups of countries, but four: (a) the ‘‘incumbent’’ developed countries; (b) the ‘‘catching-up’’ countries that are growing through industrialization and structural transformation; (c) the ‘‘commodity-boom’’ countries that are benefiting from the high commodity prices; and (d) the ‘‘aspiring’’ countries, those low-income, resource-poor countries that have yet to build their productive capacities to move up the income ladder.

32. The declining terms of trade of manufacture creates incentives for the catching-up and the aspiring countries to boost production and trade. Catching-up countries are in a position to expand production of new products and provide services that are subject to less competition and can demand higher returns. Commodity-boom countries have the incentive to further specialize in primary products.

33. The asymmetric incentives resulting from the commodity boom and the interaction of these four groups of countries create three main long-term risks for increasing global divergence. First, there is the risk that some incumbents, facing high unemployment and slow growth, would oppose the rise of the catching-up economies and prevent them from closing the income gaps. Secondly, there is the risk of commodity-boom countries getting trapped in specializing in fewer economic activities that are more volatile and prone to rent seeking, thus reducing the prospects for long-term growth — similar to the experience of periphery countries during the industrial revolution. Thirdly, the aspiring countries, faced with decreasing prices for their manufactures and the incentives to specialize in low-skill industries, fail to create new economic activities and productive employment and fall further behind.

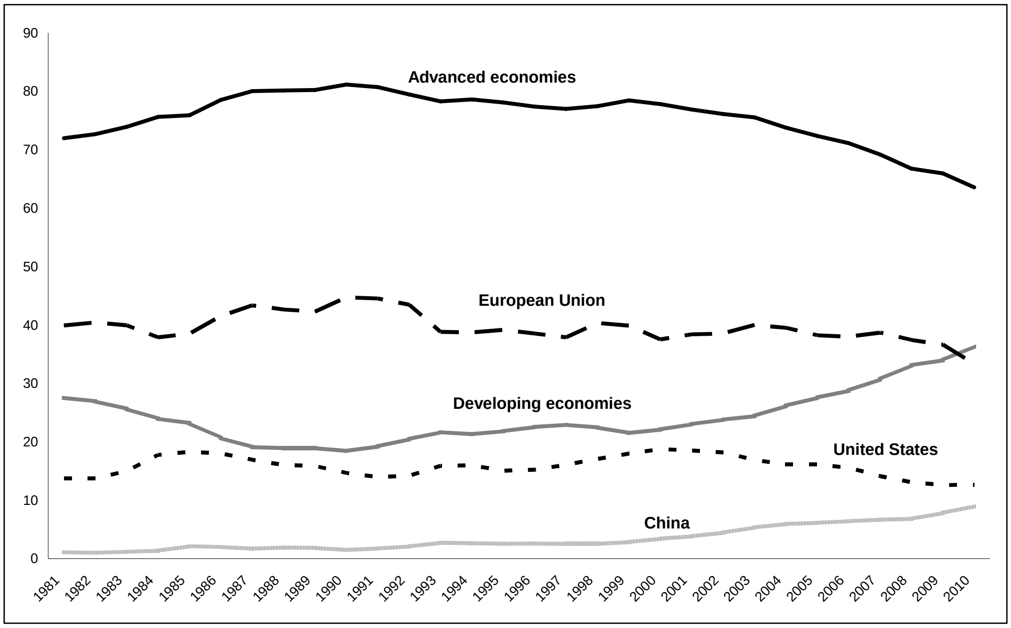
34. In addition, all countries face the further risk that high food prices would hit hardest at their most vulnerable people and increase hunger and poverty, with social and economic impacts that are severe and long-lasting.

The need for continuing manufacturing-led growth

35. For the developing economies in the Asia-Pacific region, the major obstacle to manufacturing-led growth may not be slower global demand. As indicated in figure VIII, the long-term series show that, even before the 2008 economic crisis raised doubts about the sustainability of export-led growth, global demand was shifting towards the emerging and developing economies. Emerging economies have been increasing their share of global imports consistently since the early 1990s. In the past decade, this share has increased by more than a half, from an average of

22 per cent in 2000, to 36 per cent in 2010. China has made the largest contribution in the past decade: tripling its share of global imports to 9 per cent in 2010. On the other hand, share of global imports by the advanced economies declined from 78 per cent in 2000, to 63 per cent in 2010. The main source of decline has been the United States, which between 2000 and 2010 reduced its share of global imports from 18 to 12 per cent. After 2009, share of global imports of the European Union also reduced, dropping by 3 percentage points.

Figure VIII
Share in global imports
(percentage)



Source: ESCAP, based on data from the IMF database, *Direction of Trade Statistics*, available from http://elibrary-data.imf.org (accessed August 2011).

36. The growing importance of emerging economies as the destination for global exports is expected to continue in the near future. By 2020, Asia will have more than half the world's middle class, who will account for over 40 per cent of global middle-class consumption.[3]

37. A greater threat may be the opposition within some incumbent countries to the heterodox growth strategies of the catching-up countries. Many people in the richer countries that are facing unemployment and slow growth argue that the emerging economies are bending the rules of globalization in their favour and engaging in unfair trade practices.

38. This represents a shift in attitude. Previously, the incumbent countries largely ignored the non-orthodox economic policies of the catching-up countries, including industrial policy, infant-industry protection, export subsidies, trade protection and

[3] Homi Kharas, *The Emerging Middle Class in Developing Countries*, Organization for Economic Cooperation and Development (OECD) Development Centre Working Paper No. 285 (2010).

exchange-rate undervaluation (all of which had been, and still are, implemented by the now developed economies).[4] The implementation of these policies has become more subtle with the establishment of the World Trade Organization, but they have not disappeared. Currently, the incumbent countries are paying more attention to developing countries as prospective competitors. The smaller catching-up economies may still be able to adopt these policies unopposed but the larger ones would find difficulty doing this.

39. The larger catching-up economies have a long way to go to reach the levels of income and other social and economic indicators achieved by the incumbent countries — and have yet to diversify their economies and create sufficient productive employment. While continuing with manufacturing-led growth, catching-up economies should also aim to increase domestic consumption. Such inclusive growth would not only reduce poverty but also boost aggregate demand and support growth itself. This could be accomplished by increasing wages in line with increased productivity and by ensuring the health and education of future generations so as to draw more poor people into productive economic activity.

Avoiding the natural resources curse

40. Commodity-boom countries aiming to mitigate the risk of Dutch disease need to shield import-competing and non-resource export sectors from de-industrialization and foster economic diversification and productive employment. With a view to achieving this, they should require their resource sectors to foster linkages and complementarities with the non-resource sectors — to encourage spillover of technology and knowledge and facilitate diversification towards export goods. Development banks, for example, could finance new economic activities that would expand productive capacity and increase employment, and use resource rents to finance the transfer of technology and accumulation of capital. These countries should also boost their human capital, such as engineers and technicians, to foster technical progress in resource exploration, extraction and potential substitution.

41. Commodity-boom countries should also adopt tax policies that encourage greater spending on domestically produced goods and less on imports, including, for example, restricting consumption of imported luxury goods. For this purpose, they should also remove taxes on the imported raw materials that are used by local enterprises making goods that will substitute for imported goods.

42. Poorer commodity-boom countries will also need to set appropriate monetary policies. This could entail buying foreign currency to weaken their exchange rates. Such a move would help to build up international reserves, which protect the country from capital-account volatility. To sterilize the monetary effect of an increased supply of domestic currency, central banks could absorb the excess liquidity by issuing interest-bearing bonds. Countries could also counteract the pressures for exchange-rate appreciation by loosening Government regulations on investment abroad. A balanced menu of monetary policy instruments would minimize policy dilemmas, such as the risk that rising interest rates would attract even more capital inflows.

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[4] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (London, Anthem Press, 2002).

43. Commodity boomers also face the risk that volatile commodity prices can destabilize their economies. They should, therefore, use resource flows efficiently and smooth the ups and downs in revenue. One way to achieve this would be to channel the resource windfall away from immediate consumption and into productive investment abroad through sovereign wealth funds. These would enable current generations to pass on the equivalent value of the natural assets. For example, three decades ago, some of the Arab States had oil and little else. As a result, they decided to create a fund so that future generations would, instead of oil, have the wealth created by a diversified economy.[5]

The need for balanced economic integration

44. Low-income countries with few natural resources but abundant labour have the potential to exploit the opportunities of free trade to climb the development ladder through labour-intensive manufacturing. This was the growth story of Japan during the nineteenth century. When Japan opened to free trade in 1858, it used its comparative advantage of cheap labour for silk and textile manufacture to drive industrialization. Consequently, its terms of trade increased as the prices of its labour-intensive exports rose to international levels and the price of land- and capital-intensive imports fell to world market levels.[6] The same has happened subsequently with other Asia-Pacific labour-abundant countries that have opened to trade. The garment industry in Bangladesh that developed in the 1980s is another example.

45. However, this time the gains of trade had already been captured by the 1990s, and since 2000 the terms of trade of labour-abundant countries have, in fact, deteriorated. Rather than doing more of the same, therefore these countries need to produce and trade new and more sophisticated products. Once they move to a new labour-abundant product, its price will increase until it catches up with international prices. The challenge is the decline in the prices for labour-intensive manufactures, which reduces the gap between the entrance price and the price in the world market. The lower the gap, the lower the incentive to enter the new market, which in any case is always risky in countries that face all sorts of market and government failures.

46. When aspiring countries fail to create new economic activities and sufficient productive employment, many of their citizens will migrate overseas in search of better opportunities. This will have the benefit of generating flows of remittances, but may also expose the country to Dutch disease. Remittances are usually used for consumption instead of productive investment and the subsequent influx of foreign currency and more price-competitive imported goods could stifle local manufacturing.

47. Aspiring countries need to balance the short-term gains from exploiting their current comparative advantages in low-skill industries with the long-term need to foster new economic activities. For this purpose, they should reduce their reliance on a few labour-intensive manufactures and diversify by inserting themselves into the supply chains of catching-up economies. This should be possible since rising

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[5] Paul Collier, *The plundered planet: how to reconcile prosperity with nature* (Penguin Books, 2011).

[6] Jeffrey G. Williamson, *Trade and Poverty: When the Third World Fell Behind* (Cambridge, Massachusetts, MIT Press, 2011).

wages in the fast-growing catching-up economies may cause them to shift some activities to lower-cost aspiring economies.

Coping with high food prices

48. High food prices have severely affected low-income developing economies in that they threaten food security, increase inflation and slow the rate of poverty reduction. The impact can be seen directly or indirectly in macroeconomic aggregates, such as consumption, investment, output, overall inflation and the trade and fiscal balances. Increased import prices also affect the terms of trade and the trade balance, creating pressure for exchange-rate depreciation, which leads to higher prices for other imports and inputs for production. There is then a second-round impact on wages, leading to further inflationary expectations which in turn may lead to higher interest rates. Higher interest rates, along with an inflationary environment, also discourage new investment.

49. More importantly, however, food price rises hurt the poor who are net buyers of food and leave them less income to spend on other priorities, including health and education. Although the impact may vary by household, commodity and country, high prices are more likely to increase poverty than reduce it.[7]

50. To avoid this, several countries have addressed rising prices through food-based safety net programmes. Afghanistan, for example, has targeted a food support programme at vulnerable populations. Armenia has introduced a targeted family benefit programme. Georgia has introduced a targeted social assistance programme and untargeted food coupons. India has released buffer stocks of wheat and rice and distributed wheat and rice to targeted poor families. Uzbekistan has introduced targeted food benefits and child and maternity nutrition programmes. Mongolia has introduced targeted food stamps. Indonesia has introduced a subsidized programme of rice for the poor. And the Philippines has introduced a rice subsidy programme.[8]

51. For social protection, many developing countries in Asia and the Pacific have some way to go: only 20 per cent of the population have access to health-care assistance; only 30 per cent of the elderly receive pensions; and only 20 per cent of the unemployed and underemployed have access to labour market programmes, such as unemployment benefits, training or public works programmes, including food for work.[9]

52. The best way to reduce food prices in the long term is to increase agricultural productivity. The main drivers of increased agricultural productivity are new and improved technologies. Cultivation practices such as zero-tillage, which involves injecting seeds directly into the soil instead of sowing on ploughed fields, combined with residue management and proper fertilizer use, can help to preserve soil moisture, maximize water infiltration, increase carbon storage, minimize nutrient runoff and raise yields. Fertilizer use can also be reduced by taking greater

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[7] Maros Ivanic and Will Martin, *Implications of higher global food prices for poverty in low-income countries*, World Bank Policy Research Working Paper No. 4594 (April 2008).

[8] Asian Development Bank, *Global Food Price Inflation and Developing Asia* (Manila, Asian Development Bank, 2011).

[9] Economic and Social Commission for Asia and the Pacific, *Economic and Social Survey of Asia and the Pacific 2009* (United Nations publication, Sales No. E.09.II.F.11).

advantage of organic sources of nutrients, including animal manure, crop residues and nitrogen-fixing legumes.

53. Another powerful tool for boosting the productivity of crops, livestock, fisheries and forests is biotechnology. Though the general public usually associates agricultural biotechnology with genetic modification, there are many other useful forms, including genomics and bioinformatics, market-assisted selection, diagnostic procedures, micropropagation, tissue culture, cloning, artificial insemination and embryo transfer.[10]

54. In addition, mobile telephones are helping small farmers to obtain information on crop prices and related matters. Raising agricultural productivity will also depend on better irrigation and water management. Major priorities include stepping up public investment, pricing irrigation water and electricity more rationally and using groundwater resources more equitably and profitably.

55. Developing countries also need to add value to agricultural production by extending their agroprocessing industries. Much of this investment can come from private-sector participation in agricultural research, extension and marketing — especially with the advent of biotechnology and greater protection for intellectual property. The returns to investment on research and extension are much higher on agricultural growth compared with other investments. However, private-sector participation tends to be limited to profitable crops and to enterprises undertaken by resource-rich farmers. The public sector needs therefore to fill the gaps by addressing the post-harvest issues facing the poorer farmers in less-endowed regions. Agricultural extension should also be improved through the active involvement of farmers and non-governmental organizations.

56. Agricultural productivity can also be boosted by South-South and triangular cooperation on knowledge and technology transfer to help foster a second green revolution in Asia and the Pacific. Across the region, a number of institutions have been generating new knowledge and technology in agriculture and making it available to national agricultural research systems for adaptation to their geoclimatic conditions. These include the system of institutes of the Consultative Group on International Agricultural Research.

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[10] N. C. Rao and S. Mahendra Dev, *Biotechnology in Indian Agriculture: Potential, Performance and Concerns* (New Delhi, Academic Foundation, 2010).