ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

BULLETIN ON ASIA-PACIFIC PERSPECTIVES

2002/03

ASIA-PACIFIC ECONOMIES: SUSTAINING GROWTH AMIDST UNCERTAINTIES

UNITED NATIONS

ESCAP WORKS TOWARDS REDUCING POVERTY AND MANAGING GLOBALIZATION

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FOREWORD

This issue of the *Bulletin on Asia-Pacific Perspectives* provides an assessment of the most recent developments in the global economy and their impact and implications for various economies or groups of economies within the ESCAP region. A more detailed review is undertaken in the annual *Economic and Social Survey of Asia and the Pacific*, published in April. The assessment benefited greatly from the collective wisdom of eminent persons from 14 member countries of ESCAP as well as other international organizations.

The mid-term review comes at an ambivalent time in global and regional development. Following a brief global downturn in the latter part of 2001, the strong signs of resumed growth in the earlier part of this year generated considerable optimism, which then started to dissipate somewhat in the wake of several adverse developments in mid-2002. Nevertheless, economic growth in the ESCAP developing region during this year was generally stronger than in 2001, a welcome out-turn that embodied both external and domestic economic stimuli.

The dynamics of global and regional interdependence remains the focus of the shorter articles in the *Bulletin*. These articles provide a perspective on some of the major policy challenges in ensuring stable and equitable economic growth and social development in the ongoing management of constant change. This issue of the *Bulletin* is thus an integral part of the concerted efforts that are being made to enhance the role and relevance of the secretariat in the ESCAP region.

Finally, I wish to put on record my deep appreciation to the eminent persons who so generously gave of their time in support of our work in the secretariat and to the high-level experts for their written thoughts and perspectives on major issues of concern to us all.

Kim Hak-Su
Executive Secretary

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Experts from outside the ESCAP secretariat contributed to the *Bulletin* in signed articles and in comments and suggestions at various stages of preparation. Chapter I, as the anchor article on international developments and regional implications, chapter IV, a perspective on good governance, chapter VIII, on regional financial cooperation in East Asia, and chapter VI, on empowering women through self-help microcredit programmes, were discussed at a Meeting of Eminent Persons on Current and Prospective Economic and Social Performance in the ESCAP Region held at ESCAP, Bangkok, on 24 and 25 October 2002. The Eminent Persons, who attended the meeting in their personal capacities, and other participants were: Ronald Charles Duncan (Australia), Rehman Sobhan (Bangladesh), Jiahua Pan (China), M. Govinda Rao (India), Djisman Simanjuntak (Indonesia), Shinichi Ichimura (Japan), Ragayah Haji Mat Zin (Malaysia), Yuba Raj Khatiwada (Nepal), Ashfaque H. Khan (Pakistan), Wook Chae (Republic of Korea), Vladimir V. Popov (Russian Federation), Chia Siow Yue (Singapore), Pisit Leeahtam (Thailand), Le Van Chau (Viet Nam), Robert England (UNDP, Bangkok) and Kazi Matin (World Bank, Bangkok).

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OVERVIEW

The first few months of 2002 were characterized by a sense of optimism as most observers felt that the world economy and much of the ESCAP region, despite experiencing a series of major shocks, had nevertheless displayed remarkable resilience. In the United States of America, the world's largest economy, following a brief downturn in the last quarter of 2001, growth had resumed in the first quarter of 2002 at a seemingly brisk pace aided by supportive monetary policies. Although the European Union (EU) failed to match the United States in dynamism, Japanese GDP grew marginally in this period. There was a growing consensus that strong growth in the United States would translate itself into faster world trade growth as the year progressed, with beneficial effects for the developing countries generally and, more specifically, growth in the ESCAP region. Overall, the signs until well into the second quarter of 2002 suggested that the global economy had recovered smartly after one of the shortest and shallowest downturns in recent economic history.

The optimism in early 2002 had dissipated by mid-year

Within a matter of weeks, towards the middle of the year, optimism was largely dissipated. The succession of major corporate accounting frauds and bankruptcies in the United States, together with a lack of evidence that corporate earnings were recovering in line with the apparent strength of the United States economy, severely undermined confidence in United States stock markets and, indeed, in stock markets across the globe. Closer scrutiny of United States first quarter data revealed that the numbers underlying the seemingly strong pace of GDP growth reflected an inventory rebound; there was little evidence of a significant upturn in hitherto-depressed corporate capital expenditures. These misgivings turned to alarm when it became known that the United States economy had actually grown at a listless 1.3 per cent annual rate in the second quarter of 2002 and first quarter growth was revised downwards. More seriously, revisions to 2001 data showed that, contrary to what had been announced earlier, the United States economy had actually contracted for three quarters in 2001 before recovering in the fourth. Overall growth for 2001 was consequently revised from 1.2 per cent to a mere 0.3 per cent for the United States, its worst performance since 1991.

[1] Prepared by Shahid Ahmed, Economic Affairs Officer, Development Research and Policy Analysis Division, ESCAP.

The result was that business confidence plummeted and by September 2002 confidence in a robust global recovery in 2002 had all but evaporated. Forecasts for the global economy based on a combination of official estimates are given in table 1.

Table 1. Selected indicators of global economic conditions, 1999-2003

(Percentage)

		1999	*2000*	*2001* [a]	*2002* [b]	*2003* [b]
Economic growth (percentage change of GDP)						
World		2.9	3.9	1.4	1.7	2.9
Developed economies		2.7	3.8	0.8	1.7	2.5
Japan		0.8	2.4	–0.3	–0.5	1.0
United States of America		4.2	3.8	0.3	2.5	3.0
European Union		2.4	3.5	1.6	0.8	1.8
Developing economies		3.5	5.7	3.9	4.2	5.2
Developing countries in the ESCAP region		6.3	7.0	3.1	4.9	5.7
Growth in volume of trade (percentage) [c]						
World		5.3	12.6	–0.1	2.1	6.1
Developed economies	Export	5.2	12.0	–1.1	1.2	5.4
	Import	7.8	11.8	–1.3	1.7	6.2
Developing economies	Export	4.3	15.0	2.6	3.2	6.5
	Import	1.3	15.9	1.6	3.8	7.1
Inflation rate (percentage) [d]						
CPI in the developed economies		1.4	2.3	2.2	1.4	1.7
CPI in the developing economies		6.9	6.1	5.7	5.6	6.0

Sources: United Nations, *Global Economic Outlook* (October 2002); IMF, *World Economic Outlook, September 2002: Trade and Finance* (Washington, 2002); and *The Economist* (London, 14 September 2002).

[a] Estimate.
[b] Forecast.
[c] Exports and imports (goods and services).
[d] Developed and developing economies ratios weighted at purchasing power parity.

The ESCAP region was apparently immune to the worsening external environment

In the ESCAP region the effects of these changes have primarily manifested themselves in swings in overall business sentiment. There has been a weakening of stock markets that had risen strongly in early 2002 in anticipation of a strong pick-up of the global economy later in the year. Notwithstanding growing doubts about the strength of the global recovery and weaker business confidence, expectations for overall GDP growth in the region have, however, remained surprisingly upbeat. Indeed, the latest forecast by the United Nations *World Economic and Social Survey* identifies Asia and the Pacific as the fastest-growing region in the world in 2002 with ESCAP developing economies likely to show output growth of 3.2 percentage points more than the growth in global output. This apparent immunity to the weakening external environment extends over much of the region. There is naturally some variation in subregional growth patterns but this has more to do with the relative strength of domestic factors in the different subregions than the impact of global developments. In East and North-East Asia, GDP growth in China and the Republic of Korea up to the middle of 2002 has been in excess of forecasts made at the beginning of the year. In addition, the economies of Hong Kong, China, and Taiwan Province of China, despite showing negative or only marginal output growth in the first quarter of 2002, are nevertheless expected to exceed their 2001 performance comfortably. In South-East Asia, Malaysia, the Philippines and Thailand are expected to match forecasts made for 2002 at the beginning of the year, while Indonesia and Singapore are expected to fall marginally short, the latter after having grown strongly in the first half of the year. In the other subregions, quarterly GDP data are available only for India, the Russian Federation and Turkey. Based on performance up to the middle of 2002, GDP growth in 2002 is expected to fall very slightly below expectations in India and to exceed forecasts in the Russian Federation and Turkey. It is worth noting that in the case of the latter two forecasts had been pitched on the low side following the lacklustre performance of those economies in 2001. In the developed countries of the region, Japan's economy is anticipated to contract at a slower pace than expected at the beginning of the year while Australia and New Zealand are broadly expected to match forecasts made at the beginning of the year. Overall, at the time of writing, it seems that the ESCAP region should escape any noticeable deterioration in performance compared with forecasts made at the beginning of the year.

Intraregional trade was an important factor in supporting growth

This welcome development is the outcome of both external and internal causes. On the external front, regional and bilateral trading links have fuelled trade dynamism in the region in 2001 and 2002. FDI-induced componentization of production, especially in South-East Asia, has given rise to enhanced trade flows within the region. Above all else, the region is home to some of the most dynamic economies in the world. In the latter context, there is ample evidence that trade accompanies growth just as much as growth accompanies trade. It is interesting to note, for instance, that whereas imports by Japan, the largest economy in the region, grew by 22 per cent in 2000 and then declined by 5 per cent in 2001, China, the second largest economy in the region, increased its imports by 40 per cent in 2000 and 14 per cent in 2001. The available evidence suggests that these trends are being maintained in 2002 although the pace has slackened somewhat. Moreover, the evidence also suggests that intraregional trade has moved beyond the trade in ICT components to embrace a wider range of non-ICT products and services as well. On the internal front, fiscal stimulus and monetary easing have supported the growth of domestic demand though with some attendant risks.

While it would be premature to draw any longer-term conclusions from first-half performance in the ESCAP region, it seems that many economies of the region have found new sources of strength to stimulate output growth in 2002. Following the export-led recovery in 1999 and 2000 and the sharp slowdown suffered in 2001, occasioned by the collapse in ICT demand in the United States, several economies in the region have been boosting growth with a significant degree of fiscal and monetary stimulation. Some economies, for example in South Asia, have traditionally been less export-driven and more domestic demand-driven, but in the two largest economies of the region, China and India, domestic investment expenditures and consumption demand, though dampened by factors such as the weather and floods, have propelled output growth side by side with the stimulus provided by net exports. In both 2001 and 2002 a new and not entirely unexpected source of strength in the region is the part played by the increase in intraregional trade arrangements between the developing countries of the region.

However, future prospects continue to be uncertain

Against this somewhat ambivalent background, prospects for 2002 and 2003 for both the global economy and the ESCAP region remain positive though with some underlying uncertainty. This uncertainty is compounded by the threat of war in Iraq, which could potentially exacerbate the weaknesses in the global economy.[2] One effect that is already making itself felt is the rise in oil prices, which will negatively influence the terms of trade for the region. While there are some grounds for optimism as far as the ESCAP region is concerned that growth will remain largely unaffected by the weakening global economy in the short term at least, risks on the downside should not be ignored. It has to be remembered that global trade and the stimulus provided by expanding exports to the United States and Japan have been major factors in output growth for many economies in the region, especially following the 1997 crisis. Given this, the principal influences for the ESCAP region are essentially the following:

First, global conditions generally and the outlook for the United States and Japanese economies in particular remain critical influences on economic performance in the region. In this respect, as stated above, confidence in a robust recovery in the United States and by inference in the global economy in 2002 has been significantly eroded in recent months. Strong bearish forces have gripped stock markets in the United States and in much of the rest of the world and holders of wealth in the form of equities have suffered major losses, although rising house prices have been an offsetting factor helping to preserve household wealth.

Second, at this stage it is not possible to predict how these various forces are likely to make themselves felt in 2002 and 2003. The current consensus is that in the United States consumer confidence should remain largely intact in the months ahead, underpinned by a buoyant housing market. As such, a revival of corporate capital spending in 2003, the one missing element in a stronger recovery in that country, could provide a new impetus for output growth. Elsewhere, in the EU, after easing slightly in the second half of 2002 economic growth is expected to pick up in 2003. Even in the case of Japan, the consensus view is that it is likely to experience a less severe output contraction in 2002 than was forecast earlier in the year, followed by a slow but positive recovery in 2003.

ESCAP growth is likely to be on target in 2002 and to accelerate somewhat in 2003

Third, for the ESCAP region these trends and the balance of probabilities implicit in them suggest that growth should be in accordance with forecasts for 2002 followed by a further, though, in all likelihood, modest acceleration in 2003. Details of forecasts for output growth in 2002 and 2003 in the main economies of the region are discussed elsewhere in the chapter. At the same time there are concerns that global and hence

[2] For one view, see Sachs (2002).

regional stock market weakness could persist for a considerable time, well into 2003, not only aborting a revival in corporate capital spending but ultimately impacting on consumer confidence and spending in the region as well. Moreover, persistent weakness in United States stock markets, in which foreign investors are major participants, could lead to a disorderly repatriation of liquidated investments from the United States, undermining global financial markets. This could, in turn, generate adverse repercussions on both corporate and consumer confidence virtually across the globe. Finally, in a weakening overall economic environment, risk aversion by investors could intensify, resulting in a sharply reduced availability of finance for non-investment grade borrowers, both corporations and countries.

Policy issues the region must contend with

What are the policy issues that arise for the region from the foregoing analysis? The relevant issues were raised in the *Bulletin 2001/02* but as is self-evident the implied policy trade-offs are constantly evolving and have to be examined afresh. They also vary between subregions and between countries. However, their main features as viewed from the current perspective are highlighted below.

- **One**, how can economies preserve the momentum of growth and thus counter the social distress that slower growth inevitably brings in the face of a global economic environment that is weakening once again?
- **Two**, how efficacious is it to rely on fiscal and monetary stimulus, and what are the pitfalls of doing so, particularly in economies where the burden of public debt is already on the high side, as in South Asia, or where inflation is low and declining, as in East Asia?
- **Three**, what are the likely implications for the ESCAP region of external developments such as the realignment of the dollar exchange rate vis-à-vis other world currencies and a rapid correction of the long-standing and now growing United States current account imbalance?
- **Four**, how can the stock markets of individual countries in the region and, indeed elsewhere, sustain the confidence of market participants in the face of intensified bearish trends in the United States and other developed country stock markets?
- **Five**, what are the areas and the scope for national and regional policy initiatives, in both the short and long terms, with regard to the questions raised here? Interwoven with these issues are policy measures needed to mitigate the negative effects on employment of a slowdown in the ESCAP region.

These and other matters bearing upon global economic trends and their likely impact on the ESCAP region are considered at greater length in succeeding sections. The relevant policy options can be summarized here as follows:

- **One**, a commitment to preserve growth through domestic demand stimulation within a framework of macroeconomic stability is needed. There are major shortcomings in the physical infrastructure of many, if not most, developing ESCAP economies. Investment in infrastructure alongside expenditure on human resources development will not fully offset the diminution in external demand but will contribute both to short-term growth and to improving long-term competitiveness.
- **Two**, maintaining macroeconomic prudence depends primarily on having a credible approach to the risks of policy slippage. Governments have in the past been somewhat lax in their commitments in this regard. A low inflationary environment allows somewhat more policy leeway than in the past but Governments should be alive to the risks of both overshooting and undershooting macroeconomic objectives.
- **Three**, a volatile external environment and exchange rate instability should not interfere with the progress towards trade liberalization, whether taking place on a multilateral or bilateral basis. Trade liberalization is not only a matter of reducing tariffs but of actively removing the more mundane impediments to trade such as customs clearance procedures and cumbersome trade-financing mechanisms.
- **Four**, the highest standards in corporate governance should continue to be promoted and agreement sought within the region on the minimum standards of enforceability in corporate reporting.
- **Five**, regional cooperation in trade and financial matters should continue to be emphasized while national competitiveness is promoted at the same time.

GLOBAL ECONOMIC DEVELOPMENTS

Developed countries

The global slowdown in 2001 was reflected in a sharp drop in world trade

As was reported in the *Economic and Social Survey of Asia and the Pacific 2002*, the developed countries experienced an unexpected and sharp slowdown with 2001. In terms of the global impact, the slowdown manifested itself in a precipitate decline in world trade in 2001 compared with 2000, with the growth in the volume of trade slowing sharply and actually declining in value terms. The slowdown was driven by an abrupt deceleration in corporate capital spending in ICT, which was itself caused by rising inventories, declining profits and growing indebtedness in corporations. There was evidence of a tentative turnaround in global output growth led by the United States in the first quarter of 2002 but this was primarily the result of a cyclical inventory turnaround; there was little or no evidence of a revival in corporate capital spending, the main driver of growth in the United States in the second half of the 1990s. In fact, the balance sheets of corporations have weakened in 2001-2002, gearing ratios have worsened and access to finance for many has become restricted, especially for the less creditworthy, paradoxically in the face of easier interest rates.

The slowdown was a result of the bursting of the asset price bubble in the United States

An important feature of the 2001-2002 slowdown, briefly interrupted by growth in the last quarter of 2001 and the first half of 2002, has been that it has not been the result, as has usually been the case in the past, of a deliberate policy tightening in the face of rapid growth leading to supply constraints and price pressures. It has instead been a spontaneous correction of an asset bubble in the shape of overinflated valuations of ICT-related stocks that had encouraged too many companies with only the rudiments of a business plan to raise capital in the stock markets. Investors, for their part, encouraged by extravagant claims on behalf of ICT and the so-called new economy, eschewed scepticism and were instrumental in inflating the bubble. The result was that capital was misallocated on a massive scale. Much of it will have to be, and is being, written off. These matters were alluded to in the *Economic and Social Survey of Asia and the Pacific 2002* as well as in the previous edition, where the risks facing the global economy from the bursting of the ICT bubble were also analysed. It was stressed then that the overhang of excess capacity and debt could take a long time to work itself out, generating a prolonged period of volatility in the stock markets. This is proving to be the case.

The 2001 slowdown originating in the United States has certain peculiar characteristics that could serve to shed light on the course of events in 2002 thus far.

First, it was triggered by and concentrated in the ICT sector for which the ESCAP region is a major supplier of inputs. Following the over-investment in ICT and ensuing massive write-offs, corporate investment expenditures have had to be effectively suspended until corporate balance sheets are rebuilt. This will involve a painful period of restructuring with many corporate bankruptcies probable.

Second, in an environment of growing optimism, exaggerated profit expectations also began to be applied to other traditional sectors of the economy as benchmarks. In response, some companies in the United States began to artificially inflate their earnings, sometimes illegally in contravention of accounting norms and standards. When these accounting malpractices were discovered, a severe crisis of confidence occurred that gravely undermined American stock markets, affecting both new and old economy shares alike. Stock markets have been weakened virtually on a worldwide basis, including the ESCAP region.

Low interest rates have kept consumption strong

Third, the impact of the associated stock market bubble occurred in an environment of negligible inflation and low interest rates. All evidence of an impending slowdown in the real economy in 2001 was met with successive reductions in interest rates in the United States, which now stand at 40-year historical lows. Interest rates have tumbled to very low levels in 2001 and 2002 in all developed countries. In Japan interest rates are, and have been, close to zero for some time, while in the EU, the European Central Bank, though constrained by its EU-zone inflation target, has reduced interest rates by almost a full percentage point in the 12 months since July 2001. In consequence, private consumption has offset the investment and inventory-driven slowdown and prevented a more wide-ranging downturn. In the United States the wealth effect of rising housing equity has counterbalanced the declining value of share ownership. But in the process it has worsened the external imbalance in the United States by causing a surge in imports and has thus introduced a new source of uncertainty into the global economy. In Japan and the EU, the position is somewhat different as regards institutional arrangements and individual characteristics, in terms of consumer behaviour and preferences, in so far as the interface between the real economy and the financial environment is concerned. The following paragraphs attempt to shed light on the relevant trends in the main developed countries.

In the United States, as already noted, stock markets continue to remain weak and volatile despite low interest rates. In the real economy there are some tentative signs of a modest upturn in manufacturing activity and private consumption has so far remained strong, with retail sales standing 6.1 per cent higher in August 2002 compared with a year earlier. Low interest rates and a buoyant housing market have driven private consumption but these sources of consumer strength cannot be presumed to continue indefinitely. Investment expenditures by corporations, a better bellwether of medium-term prospects, are expected to contract again in 2002 following the contraction in 2001.

The inflow of capital to the United States is reversing itself

Trends in the United States must be viewed against the fact that gross national saving has fallen again in early 2002, the fiscal deficit has re-emerged and the current account deficit has widened from 4.0 to 4.5 per cent of GDP. Weak stock markets have led to a gradual but steady withdrawal from, and repatriation of, dollar-denominated assets held by foreigners. These have been partly reinvested in United States Treasury bonds but a significant portion has gone into European and United Kingdom Government and corporate bonds. Bond prices have consequently risen substantially standing nearly 13 per cent higher at end-September 2002 compared with end-December 2001. Since the beginning of 2002 the dollar has depreciated against several currencies, primarily the euro, in an environment of increased volatility, and precious metal prices have also risen.

Economic growth in Japan continues to be hampered by long-standing domestic problems

In Japan, notwithstanding the fact that interest rates have been reduced close to zero, demand remains weak owing to the influence of a variety of long-term domestic factors, including chronically weak consumer confidence and structural impediments such as over-capacity and an unreformed financial sector. The impact of certain short-term factors such as the yen-dollar exchange rate is a source of additional concern. To date, the decline in GDP has been caused by both external and domestic factors. Export growth declined in 2001 following the collapse in the ICT sector in the United States, while consumption remains depressed by the massive and persistent loss of personal wealth over the last 10-12 years that is most visible in the endemic weakness in the property and stock markets. Business investment has followed an erratic course rising briefly in response to improved export prospects in 2000 but then falling back rapidly in 2001. Despite interest rate reductions, savings remain high and the balance of payments current account surplus has begun to creep upwards again to 3 per cent of GDP. The latter phenomenon has major implications for the yen exchange rate and whether growth in the near term can be driven by exports. Exports have picked up only weakly thus far in 2002, the weaker exchange rate being offset by low demand for Japanese exports.

Performance in the European Union has been flaccid

In the EU, growth faltered palpably in the first half of 2002. Barely perceptible growth in Germany, Italy, Belgium and Austria was accompanied by below-trend growth in France and the United Kingdom of Great Britain and Northern Ireland. Reflecting high levels of unemployment and poor consumer confidence, retail sales showed only modest growth up to July 2002 in the EU with the exception of the United Kingdom and some of the smaller economies. Indeed, in September 2002 unemployment stood at 8.3 per cent in the euro zone compared with 8.0 per cent 12 months earlier. Overall, the EU 15 are unlikely to meet expectations for 2002 held earlier in the year. On the plus side, the recent appreciation of the euro and the pound sterling in the face of monetary easing should counter any lingering threat of inflation breaking official targets, giving some room for monetary easing. On the minus side, however, the overall climate of uncertainty generated by stock market turmoil and concerns about the strength of the United States economy are likely to dampen both non-euro zone export growth and capital investment in the second half of 2002. Moreover, in the face of persistent high unemployment, consumer demand is unlikely to provide a major stimulus to activity in the short term. Only in Denmark, Sweden and the United Kingdom, the three economies outside the euro zone, is consumer spending showing a degree of buoyancy. The United Kingdom economy is very similar in this respect to that of the United States with rather low business confidence being offset in large measure by strong consumer spending on the back of a strong property market.

The major developed economies are unlikely to be engines of global growth in the near term

Looking ahead over the next 4-6 quarters, the balance of forces currently arrayed in the developed countries seems to be evenly poised between slightly higher or flat GDP growth on the one hand and output contraction on the other. The view of the United States Federal Reserve Board is that recovery in the United States is likely to remain sluggish and that risks, by and large, are weighted towards continuing weakness. Earlier in the year, IMF was guardedly optimistic about both United States and global economic prospects. However, in the absence of a visible turnaround in business sentiment and greater likelihood of negative influences adversely affecting consumer spending, such as stock market turmoil or a weaker housing market, forecasts for both 2002 and 2003 have been scaled down for both the United States and the EU. For Japan, the consensus is that the economy will contract in 2002 but by less than was feared earlier in the year. It should, however, show positive growth in 2003. None of the major developed countries is thus likely to have a positive influence on the global economy in the short term. Prospects for the developed countries must also be viewed against an environment characterized by low and declining inflation and low interest rates but with some uncertainty as regards the fiscal situation. With regard to the latter, despite recent spending increases there remains some modest scope for fiscal stimulus, particularly in the United Kingdom. However, the EU is constrained by its Growth and Stability Pact while Japan's public debt is already uncomfortably high. The implications of these phenomena are discussed more fully elsewhere in the chapter.

Developing countries

Weak commodity prices worsened the impact of the global slowdown on developing countries in 2001

The sharp slowdown of the global economy in 2001 inevitably impacted adversely on the developing countries with lower growth in output and further weakness in commodity prices and implied terms of trade losses (table 2).[3] Despite widespread easing of fiscal and monetary policies the loss of the external stimulus could only be partially compensated for by growth in domestic demand in 2001. Accordingly, there were severe declines in output in economies with high export-to-GDP ratios generally or with a large preponderance of exports to the United States. Although this assessment was generally true for the region there were important exceptions as well. Notably, China and India were largely immune to the slowdown in 2001.

Table 2. Indices of commodity prices, 1996-2002

(1995 = 100)

	1996	*1997*	*2000*	*2001*	*2002 June*
World	98.8	95.7	77.3	73.1	73.3
Food	112.2	100.1	73.5	75.8	79.9
Beverages	82.6	109.5	61.0	49.4	51.7
Agricultural raw materials	97.3	91.0	79.4	74.0	71.0
Metals	88.1	90.7	83.9	75.8	74.1
Fertilizers	113.7	115.0	107.4	101.2	100.5
Memo:					
Palm oil (Malaysia)	84.6	86.8	49.2	45.6	64.7
Rice (Thailand)	105.4	94.3	63.5	53.8	63.0
Rubber (Malaysia)	88.7	64.4	43.7	38.0	53.1
Sugar (US import price)	97.0	95.1	84.1	92.5	86.7
Tea (Sri Lanka)	126.5	134.5	119.9	114.3	114.1[a]
Timber:					
Hardwood logs (Malaysia)	98.5	92.4	73.8	62.2	63.4
Hardwood sawnwood (Malaysia)	100.1	89.5	80.9	66.0	69.2
Softwood logs (United States)	105.3	95.6	93.3	81.4	70.6
Softwood sawnwood (United States)	103.1	97.8	94.7	94.1	75.0

Sources: IMF, *International Financial Statistics Yearbook 2001* (Washington, 2001); and *International Financial Statistics* (Washington, August 2002).

[a] March.

[3] The all-items commodity index of *The Economist* had declined by nearly 15 per cent in the 12 months to October 2001. It has since risen somewhat but at 73.2 stands almost 27 per cent below its level of 1995 (2002).

Domestic demand and an initial export recovery were behind strengthened performance in developing countries

In late 2001 and early 2002 indicators of activity in most developing countries strengthened in response partly to domestic stimulus measures and partly as demand for exports, especially to the United States, appeared to recover. In particular, evidence of a turnaround in the United States in late 2001 led to significant upward revisions of growth forecasts for developing economies with large high-tech export sectors. Asia's slowdown in 2001 had been largely driven by the sharp decline in world demand for high-tech exports, which account for about 40 per cent of total manufactured exports from the region. A revival of demand in the developed economies generally and for high-tech exports in particular was expected to provide additional strength to output growth in the developing countries in the region and also lead to a modest firming of commodity prices. The latest indications are that, for now, the external stimulus from the United States is likely to wane in the months ahead. All things considered, growth will need to be sustained primarily by domestic measures or by intraregional trade in 2002 and perhaps well into 2003.

West Asia's economic fortunes in 2002 and 2003 primarily rest on energy demand and prices, the level of violence in the Israel-Palestine conflict and, now, more seriously the danger of military action against Iraq. The most probable consequence of the two conflicts is for energy prices to rise. Higher energy prices might benefit the energy-producing economies in the region in the short term but will almost certainly have a negative impact on global recovery. The conflicts in the region have sharply restricted investment activity and tourism in and around the countries immediately involved and any increase in their intensity would automatically depress economic activity in the entire region even if it benefited energy prices in the short term. On balance, therefore, it is unlikely that West Asia will be able to match 2001 performance in 2002. Prospects for 2003 can only be described as moderately hopeful, assuming that conflicts in the region can be contained and/or prevented and energy prices and production levels continue broadly unchanged at their present level.

Sustainable growth is foreseeable in Central Asia

In Central Asia, the larger economies are rather more diversified than in West Asia. However, here, too, energy prices continue to exert a crucial influence on their overall levels of activity and output growth. The economy of the Russian Federation has grown at a respectable pace thus far in 2002 on the back of higher energy prices and higher industrial production. Barring unforeseen developments, this pace is considered sustainable in 2002 and into 2003. The same broad scenario should apply to other economies in North and Central Asia, given their links with the Russian Federation.

In other parts of the world, for instance, the current economic situation in Latin America is dominated by events in Argentina and their fallout on the rest of the continent. Uruguay and Brazil have already fallen victim to the contagion from Argentina and both economies have had recourse to external support in order to pre-empt a complete financial collapse, Brazil having had to arrange a massive US$ 30 billion stand-by with IMF in August 2002. Uncertain prospects for the United States economy, political tensions in Colombia and Venezuela and ongoing financial market turmoil suggest that economic performance is likely to deteriorate in the short run with low or even negative output growth in all the main economies, with the possible exceptions of Mexico and Peru.

The outlook for African economies has worsened during the course of 2002

Economic performance in Africa held up relatively well in 2001 compared with other parts of the world despite the global slowdown. Until early 2002, performance was expected to strengthen further in 2002 in response to a stronger external environment. Oil-producing countries were expected to benefit in particular. The short-term outlook has, however, become less positive in the second half of 2002 in the face of increasing uncertainty in the global economy. The interaction between weak commodity prices and output, the limited ability of most African Governments to take countervailing measures on the domestic front when the external environment deteriorates and the chronic nature of internal conflicts in many countries are key influences bearing on economic performance over much of the African continent. In view of these considerations the outlook for both 2002 and 2003 suggests either no improvement over 2001 performance or, more likely, a slight deterioration.

Trade and financial market developments

An important element in the slowdown in 2001 was the role played by international trade and financial flows in transmitting changes in economic activity in the global economy. Trends in world trade and prices over the last decade and in 2001-2002 are given in table 3. The most notable feature in world trade growth is the fact that strong volume growth has been accompanied by price weakness almost across the board with the exception of oil. Capital

Table 3. World trade and prices,[a] 1991-2002

	Annual percentage changes				
	1991-2000	*1999*	*2000*	*2001*	*2002[b]*
Trade volumes	7.3	5.6	12.8	–0.7	2.6
Trade prices (in US dollars)	–0.8	–2.0	0.3	–3.5	–1.5
Manufactures	–0.9	–1.9	–5.1	–2.4	–0.5
Oil	2.1	37.5	57.0	–14.0	–5.3
Other commodities	–0.9	–7.0	1.8	–5.5	–0.1
Terms of trade					
Developed economies[c]	0.2	0.1	–2.5	0.4	0.6
Developing economies	0.0	4.5	7.4	–3.0	–1.6

Source: "IMF, World Economic Outlook" cited from BIS, *72nd Annual Report: 1 April 2001–31 March 2002* (Basel, July 2002).

[a] Goods only.
[b] IMF forecast.
[c] Advanced industrial economies plus newly industrializing Asian economies (Hong Kong, China; Republic of Korea; Singapore; and Taiwan Province of China).

flows to the developing countries and to developing Asia are given in table 4. These rose strongly up to 1996 but have been fluctuating at a considerably lower level since 1997. For example, in 2002 developing Asia is expected to receive only a quarter of the private capital flows it received in 1996. No early revival is indicated on the basis of available information.

Table 4. Net capital flows[a] of developing countries and of developing Asia, 1995-2003

(Billions of US dollars)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
Total[b]									
Net private capital flows[c]	211.5	228.8	102.2	62.1	84.8	29.4	24.9	62.4	64.9
Net private direct investment	98.2	114.4	141.7	153.6	164.0	158.0	172.1	151.3	160.9
Net private portfolio investment	42.7	90.2	46.7	–0.1	34.3	–4.3	–42.6	–3.0	–4.0
Net other private capital flows	70.5	24.1	–86.2	–91.5	–113.4	–124.3	–104.6	–85.9	–91.9
Net official flows	26.5	–2.3	68.3	69.9	12.2	0.2	15.4	20.6	18.2
Changes in reserves[d]	–118.2	–108.1	–68.8	–48.2	–87.9	–113.2	–119.9	–146.6	–129.7
Developing Asia									
Net private capital flows[c]	96.9	122.1	7.1	–45.9	6.8	–12.9	16.7	31.6	7.9
Net private direct investment	52.6	53.4	56.8	59.7	61.2	54.2	47.1	58.7	59.0
Net private portfolio investment	22.7	32.8	7.3	–17.9	14.4	4.3	–13.5	0.7	–9.7
Net other private capital flows	21.6	35.9	–56.9	–87.7	–68.8	–71.4	–16.8	–27.8	–41.3
Net official flows	4.5	–12.4	16.9	26.1	4.4	5.1	–5.7	–1.4	3.3
Changes in reserves[d]	–43.3	–46.9	–15.4	–67.4	–78.9	–48.7	–84.7	–97.4	–67.8

Source: IMF, *World Economic Outlook, September 2002: Trade and Finance* (Washington, 2002).

[a] Net capital flows comprise net direct investment, net portfolio investment and other long- and short-term net investment flows, including official and private borrowing.

[b] Excludes Hong Kong, China.

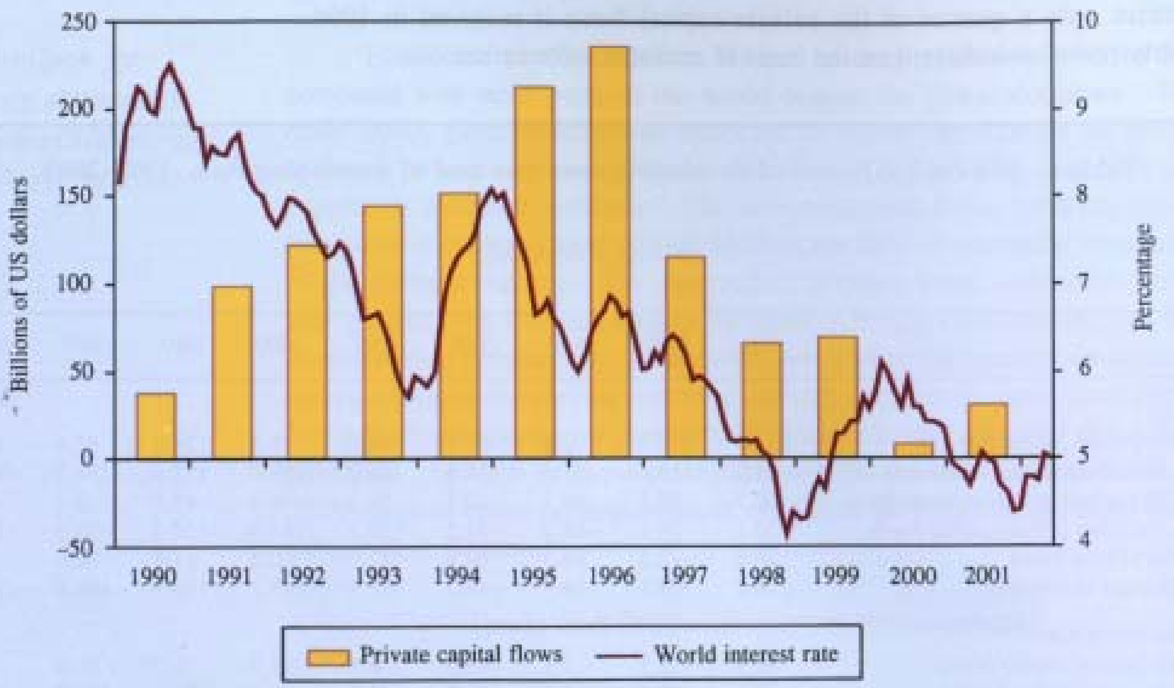
[c] Because of data limitations, "other private capital flows, net" may include some official flows.

[d] A minus sign indicates an increase.

International trade in 2003 is likely to be little changed from the previous year

As explained in previous issues of the *Survey* over the years, with greater specialization, trade flows represent an increased proportion of output in today's economies. Moreover, vertical integration implies that individual sectors are likely to be influenced by developments specific in those sectors rather than in the wider economies of the countries where particular production facilities are located. However, the ability of international trade flows to overcome country-specific macroeconomic conditions should not be overstated. World trade growth declined sharply in 2001 in tandem with the global slowdown and the best estimates for 2002 suggest an increase of only 2.6 per cent in volume terms, but this is likely to be offset by a decline of 1.5 per cent in prices. In value terms world trade actually declined by 3.5 per cent in 2001 as prices of internationally traded commodities and manufactures fell. Given the anaemic nature of the global economy and little upward pressure on prices, 2003 could well be a repeat of 2002, with a modest increase in volume and flat or declining prices.

Figure. Private capital flows to developing countries and world interest rate, 1990-2002



Source: Reproduced from BIS, *BIS 72nd Annual Report: 1 April 2001–31 March 2002* (Basel, July 2002).

Note: World interest rates are computed based on weighted average of 10-year government bond rates in the United States of America, the euro area and Japan.

Low interest rates in developed countries have not stimulated capital outflows to developing countries

Although in 2001 there was a synchronized slowdown in output growth almost across the globe, the forces propelling developments in the United States are rather different from those in either Japan or the EU. Nevertheless, there is greater convergence in financial conditions, namely, in the direction of interest rates changes, as financial markets have become more integrated in recent years and inflationary pressures have abated across the world. Thus, changes in financial conditions in one country are likely to affect others more strongly than in the past. A phenomenon observed in the 1990s was the rise in gross private capital flows from developed to developing countries as interest rates fell in the former (see figure). Is this trend likely to continue in the future? The evidence since 1999 suggests otherwise. For one thing, interest rates in many developing countries have also fallen to low levels owing to poor loan demand and monetary easing and cannot fully compensate for increased risk aversion. For another, low interest rates have fuelled higher loan demand in some of the capital exporting economies, particularly on the part of households.

Financial structures differ significantly across the world. Capital markets as a source of investment finance are typically stronger in the United States than in either Japan or the EU, where direct intermediation by banks is still common. Likewise, the housing market and housing mortgage finance are more important in household balance sheets in the United States than in Japan or the EU. This has implications for the wealth effect on consumer confidence. Lower interest rates have diverted funds from the developing countries to consumers in the United States, worsening the current account deficit as a buoyant housing market sustains the wealth effect.

Profit margins of manufacturing companies have been eroded in the United States

A feature of the global slowdown in 2001 and uncertain recovery in 2002 in the developed countries is the marked difference in performance between the domestic and externally oriented-sectors. Manufacturing output growth has been weak in the United States while residential and public construction activity has remained strong. This reflects the differentiated responses of the trading and non-trading sectors of the United States economy to recent developments. Most notably, in both 2001 and 2002, the profit margins of United States businesses in manufacturing came under increasing pressure. This phenomenon, visible in varying degrees in other developed economies as well, has been compounded by a build-up of excess capacity in several manufacturing activities. The result is that firms have lost pricing power to a significant extent, a factor that has contributed to the low rates of inflation, indeed a degree of deflation, in the United States and in many other parts of the world.

Lenders have become more discriminating in their choice of borrower

The phenomenon of low corporate profitability has, in turn, led to a marked shift in financing patterns both within and across different economies. Investment grade borrowers have benefited from the easing of monetary conditions while non-investment grade borrowers have experienced a widening of spreads, countering the effects of lower interest rates. Lenders have not been averse to shifting finance from corporate and sovereign borrowers to the personal sector for housing mortgages and personal consumption. This shift has indirectly supported strong consumer spending in the United States and reduced the impact of the diminution in corporate investment spending and rising unemployment. Such effects are less strong in Japan and the EU but are not entirely absent.

In the past, as stated above, interest rate differentials exercised a major influence on the volume of capital flows with developing countries typically receiving a higher volume of private capital flows when interest rates are low in the developed countries. In 2001 and 2002 the decline in interest rates has coincided with a weakening global economy and increased investor risk aversion. Potentially disruptive financial crises in Turkey, Argentina, Uruguay and Brazil have increased risk aversion considerably. Low interest rates no longer lead to an increase in private capital flows to developing countries. In fact, in several Asian economies cross-border lending turned positive in 2001-2002 for the first time since mid-1997. FDI flows to developing countries have remained steady but as in previous years they continue to be directed to a small number of countries, with China the principal recipient of these flows.

Credible macroeconomic policies can improve investor perceptions

Although overall capital flows to developing countries displayed a measure of resilience in 2001-2002, many countries with high debt/GDP ratios, high debt service requirements or a large element of short-term debt relative to reserves are, and will remain, highly sensitive to changes in international financial market sentiment. However, the adoption of credible macroeconomic policies can mitigate the negative effects of high indebtedness. This phenomenon is most visible in the EU candidate countries, which are perceived by investors to have policy frameworks defined by the needs of EU entry and, hence, to be less risky than other countries with similar external debt profiles.

The overall global economic and financial environment prevailing in 2002 does not suggest that private capital flows to developing countries are likely to increase in the near future. Banks are likely to remain cautious given that asset quality tends to deteriorate in slowdowns. Other investors are likely to be worried by the risks building up in Latin America. However, FDI flows are expected to remain broadly stable and the relative immunity of Asian economies to a renewed slowdown in the United States could even lead to higher FDI flows to these countries.

Little real increase is likely in ODA

ODA increased in 2001 but this was mainly on account of large disbursements by the IMF-led programmes for Argentina and Turkey. A similar phenomenon will recur in 2002 with the IMF assistance just announced for Brazil. Over the medium term, as indicated in the Monterrey Consensus adopted at the International Conference on Financing for Development in March 2002, donors are more aware of the importance of ODA for long-term development needs and for the fight against poverty. However, given the overall economic and fiscal situation in the donor countries, this is unlikely to lead to higher disbursements in 2002 or 2003 except for the special needs of Afghanistan.

Prospects for the ESCAP region

Sustaining growth in the ESCAP region will depend on stimulating domestic demand

The global economic slowdown in 2001 reduced GDP growth of ESCAP developing countries from 7 per cent in 2000 to 3 per cent in 2001. Earlier in 2002 there were some indications that a rebound in the global economy led by the United States combined with easier domestic policies would lead to a higher pace of growth in the ESCAP developing countries than the 4.2 per cent rate that had been forecast. In the event, however, the rebound appears to have lost steam in the United States and growth has failed to accelerate appreciably in either the EU or Japan on a sustainable basis. Indeed, the risks are weighted towards a period of even slower growth over the next 12 months than was forecast at the beginning of 2002. Most observers are now of the opinion that the global economy is unlikely to show strong growth until well into 2003 or possibly later; in other words, the contribution from a rebound in world trade and hence from net exports to growth in ESCAP developing countries over the next 4-6 quarters is likely to be moderate at best. Sustaining growth in 2002-2003 at around 5 per cent as currently forecast will thus depend primarily on stimulating domestic demand. Growth within the region could also be sustained and, indeed, enhanced by higher intraregional trade flows.

The evidence up to the middle of 2002 suggests that growth as forecast earlier in the year is broadly on track over much of the region. Moreover, it provides a base for the momentum to be sustained in the months ahead. In East Asia, with the exception of Hong Kong, China, GDP growth is strongly positive in China and the Republic of Korea and up to expectations in Taiwan Province of China. Indeed, in the latter, industrial production in August 2002 was 5.8 per cent higher than in August 2001 and overall GDP grew by 3.0 per cent in the second quarter of 2002 on a year-on-year basis. In South-East Asia, where trade-to-GDP ratios are among the highest in the world, growth in output has nevertheless been up to or beyond expectations. In Singapore, for instance, there has been a striking rebound in industrial production in the first half of the year, industrial output standing nearly 16 per cent higher in August 2002 than in August 2001. In South Asia, India's economy continues to expand at, or slightly higher than, its long-term rate of 5-6 per cent. However, prospects for the remainder of 2002 are likely to have been blighted to some degree by a combination of floods and drought that afflicted the country in mid-2002. Economic performance elsewhere in South Asia is also likely to be affected by either floods or drought. However, an easing of tension between India and Pakistan is likely to benefit economic performance in the subregion along with progress in macroeconomic reforms.

An outbreak of hostilities in the Middle East would undermine forecasts for 2002-2003

Given these varied trends within the region, the question that arises is whether the overall momentum of growth can be sustained and whether this apparent immunity can be preserved into 2003. Details of forecasts of growth in 2002 and 2003 are given in table 5. The forecasts are based upon the following assumptions: (a) no major hostilities in Iraq, (b) no sustained increase in oil prices or disruption in the energy markets, (c) no new extended period of turmoil in the financial markets, (d) no significant exchange rate realignments and (e) only a limited impact of floods and drought in China and India and of terrorism in South and South-East Asia.

As mentioned elsewhere, the ESCAP region has managed to grow at a reasonable pace thus far through a combination of supportive domestic policies and greater intraregional trade. As far as supportive domestic policies are concerned, there are, of course, limits beyond which it may be difficult or unwise to stimulate activity through public spending programmes or through monetary easing. One of the lessons of the 1990s emanating from Japan is that monetary easing in a low inflationary environment raises its own peculiar set of issues.

Demand from China has stimulated intraregional trade but this may slow in future

As far as intraregional trade is concerned, there is evidence that the ESCAP region has expanded trade with itself rapidly, a process in which China has emerged as a significant importer, increasing imports by a remarkable US$ 80 billion in the two years 2000-2001. The Republic of Korea, Malaysia, Taiwan Province of China, Singapore and the Philippines have been the major beneficiaries in this development. To what extent this impetus can be sustained, however, remains a subject for debate. One view is that growth in intraregional trade is likely to slow soon. This is due to the fact that demand for investment goods in the region, though expanding, remains essentially weak, given the overhang of excess manufacturing

Table 5. Rates of economic growth of selected developing economies of the ESCAP region, 2000-2003

(Percentage)

	Real GDP				
	2000	*2001*	*2002* [a]	*2002* [b]	*2003* [c]
South and South-West Asia [d]	4.4	4.5	5.5	4.3	5.4
Bangladesh	5.9	5.2	4.3	4.3	5.1
India	4.0	5.4	6.0	4.3	5.6
Iran, Islamic Republic of	5.7	5.1	6.5	5.0	5.5
Pakistan	3.9	2.5	4.0	4.5	4.6
Turkey	7.4	–7.4	2.0	2.8	4.1
South-East Asia	6.1	1.6	3.2	3.7	4.7
Indonesia	4.9	3.3	3.8	3.5	4.4
Malaysia	8.3	0.4	3.2	4.4	5.8
Philippines	4.4	3.2	4.0	4.0	4.4
Singapore	10.3	–2.0	2.0	2.5	5.0
Thailand	4.6	1.8	2.5	3.9	4.4
Viet Nam	6.8	6.2	6.1	6.1	6.7
East and North-East Asia	8.2	3.3	4.3	5.6	6.1
China	8.0	7.3	7.0	7.6	7.6
Hong Kong, China	10.2	0.6	1.0	1.7	3.9
Republic of Korea	9.3	3.0	3.9	6.0	6.2
Taiwan Province of China	5.9	–1.9	1.7	3.3	4.5
Memo:					
Russian Federation	8.3	5.0	3.5	4.0	4.0

Sources: ESCAP based on IMF, *International Financial Statistic* s, vol. LV, No. 8 (Washington, August 2002); ADB, *Key Indicators of Developing Asian and Pacific Countries 2002* (ADB, 2002) and *Asian Development Outlook 2002 Update* (ADB, 2002); United Nations, "Project LINK World Economic Outlook", April 2002; The Economist Intelligence Unit, *Country Forecast* (London), various issues; and national sources.

[a] *Economic and Social Survey of Asia and the Pacific 2002* forecast.
[b] Latest available estimate.
[c] Forecast.
[d] The estimates and forecasts for countries relate to fiscal years defined as follows: fiscal year 2001/02 = 2001 for Bhutan, India and the Islamic Republic of Iran; fiscal year 2000/01 = 2001 for Bangladesh and Pakistan.

capacity in several economies. At the same time, domestic consumption demand, while currently buoyant, is expected to taper off in the absence of sustained increases in real income in the region. Indeed, much of it is debt-financed and could thus pose systemic risks in some countries. Above all else, China's capacity to import is dependent upon its continued success as an exporter. China's export success and hence its capacity to increase imports from the region is ultimately strongly correlated to the strength of the global economy.

The weakness of the United States dollar may not be entirely negative for the region

A further influence on the region's export and growth performance over the next 12-18 months is likely to emanate from the recent weakness of the dollar exchange rate and the strengthening of several regional currencies vis-à-vis the dollar. In theory, and on the face of it, this phenomenon could have a negative impact on these countries' competitiveness. In practice, the negative impact could be relatively small. For one thing, although regional currencies have tended to strengthen against the dollar, they still remain cheaper on a trade-weighted basis than, say, before the 1997 crisis. For another, the weaker dollar allows countries to speed up their dollar debt restructuring thus freeing up resources in cash flow terms that would otherwise have been used in debt servicing. An unknown in the situation, however, is how economies whose exchange rates are fixed to the dollar, and economies whose exchange rates are not and have experienced a degree of exchange rate appreciation, are able to compete among themselves. While the Republic of Korea, Singapore and Taiwan Province of China are competitors at the higher end of the technology scale, Malaysia, Indonesia, the Philippines and Thailand compete in several lines at the lower end. India, which uniquely in the region has seen its currency depreciate against the dollar since mid-2001, is not yet a major trading economy and thus does not have a significant role in this conundrum. The trading performance of selected ESCAP economies is given in table 6. These reveal strong export

Table 6. Rate of growth of exports and imports, selected ESCAP economies

	1999		*2000*		*2001*		*2002*[a]	
	Exports	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*
Bangladesh	18.27	13.33	23.66	8.58	2.61	0.26	10.41	8.17
China	6.09	18.05	30.20	40.37	26.72	13.99	27.49	3.45
Hong Kong, China	0.06	–2.68	16.22	18.74	–12.78	–4.08	–18.74	5.20
India	5.37	8.62	14.39	9.42	0.88	–2.45	3.77	3.00
Indonesia	–0.39	–12.20	28.19	40.73	4.78	9.74	–1.17	–8.86
Iran, Islamic Republic of	60.31	–11.45	32.04	36.81	–8.02	9.70	–3.40	–7.60
Malaysia	15.08	12.30	16.09	25.50	–8.82	–8.60	3.86	13.48
Pakistan	0.07	10.63	8.49	7.31	1.55	–5.94	–9.05	–9.49
Philippines	20.27	–0.08	7.70	1.04	–9.54	13.80	–8.40	17.17
Republic of Korea	8.25	28.24	21.42	36.22	–12.16	–11.96	–0.35	0.64
Russian Federation	1.49	–29.47	68.00	49.95	–22.04	–2.56	–0.08	19.89
Singapore	4.41	9.32	20.22	21.21	–11.76	–13.82	–14.57	–15.98
Taiwan Province of China	9.96	5.76	21.98	26.49	–17.16	–23.41	–1.01	–6.37
Thailand	7.35	16.80	17.89	22.99	–5.58	0.22	–5.16	–9.55
Turkey	–1.81	–9.16	0.27	33.20	9.72	–23.53	3.40	3.56
Viet Nam	24.01	3.81	15.42	35.77	7.08	6.87	4.74	2.16
Memo:								
United States	1.51	10.99	11.77	18.10	–5.32	–4.69	–14.43	–11.58
Japan	8.06	10.49	14.06	22.14	–14.56	–5.41	–8.96	–3.27
European Union	3.09	4.58	3.04	6.19	0.38	–0.77	–8.49	–2.57

Sources: IMF, Direction of Trade Statistics CD-ROM, August 2002, and national sources.

[a] Data for the first quarter of 2002, except for Taiwan Province of China, in which case data refer to the second quarter.

growth only in China, Bangladesh and Viet Nam. In others, the rate of growth in exports in 2002 is slower than in 2001. Most observers predict a stronger upturn in the second half of 2002 on the back of surprisingly strong consumer sentiment in the region. In the following paragraphs the immediate prospects for each subregion are briefly discussed.

The strong performance of the East Asian subregion is likely to continue

In East Asia, led by the continuing strong performance of the Chinese economy, the subregion is expected to exceed 2001 performance in 2002 and sustain this momentum into 2003. The only exception to this trend is likely to be Hong Kong, China, where there are as yet no signs of an economic turn-around and up to the second quarter of 2002 the economy was contracting. However, in terms of the subregion the slack in Hong Kong, China, is likely to be more than offset by Taiwan Province of China, which has raised its 2002 forecast on the back of better-than-expected exports up to the middle of the year.

Slowing exports will hit the economies of South-East Asia hardest

In South-East Asia the overall outlook is for a gradual strengthening of the momentum of growth with domestic spending stimulating domestic production in both 2002 and 2003. However, since all economies in the subregion have relatively high trade-to-GDP ratios any slackening in the pace of export growth will automatically have a negative impact on the pace of GDP growth. Moreover, in the main economies of the subregion levels of public debt are already on the high side so that fiscal stimulus may have reached its prudential limits. Scope for additional monetary easing, however, is theoretically available with inflationary pressures relatively muted, except in Indonesia. In addition, as exchange rates have appreciated relative to the dollar, lowering interest rates should pose no significant risks via the exchange rate on any “flow through” effects of higher energy or other imported input prices.

The domestic situation is some South Asian economies is not likely to be conducive to growth

South Asian economies are the least export-driven of all in the region. Hence, the likelihood of a weaker external environment does not have the same implications for this region. However, as the economies are more domestically driven any adverse developments on the domestic front will have a negative impact on growth. Both India and Pakistan are thus likely to be affected by the prolonged tension between the two, which will divert expenditures into defence in the short term and could have a dampening effect on private investment. In addition, Pakistan has seen a significant rise in terrorism that could severely undermine both investor and consumer confidence for the foreseeable future, not to mention the diversion of both public and private resources to higher spending on domestic security. Prospects for Bangladesh are more likely to be affected by the global slowdown in view of the growing importance of non-traditional exports in its economy. Sri Lanka’s prospects have improved with the cease-fire in the domestic civil conflict.

The outlook for Central Asia is broadly positive

In Central Asia, the pace of growth is expected to moderate in 2002 from its 2001 pace in any event as economies came up against long-standing structural impediments in their transition to market-based systems. Also, problems with the lack of macroeconomic consolidation in most of the economies could hamper growth in the medium term. For now, in the

Russian Federation, output has continued to grow at slightly above the pace forecast for 2002. With energy prices tending to strengthen, the outlook for this region as a whole is broadly positive into 2003 on the back of improving external balances, rising foreign reserves and greater exchange rate stability. The latter in particular should allow more domestic and external investment to take place and keep inflationary pressures in check.

The overall outlook for the three developed countries of the region is predominantly influenced by Japan, given the size of its economy. The latest forecast for Japan indicates that despite the improved performance shown in the first half of 2002, GDP is expected to contract in 2002 by around 0.5 per cent, significantly less than the earlier forecast of a contraction of 1.2 per cent. However, as the external environment is displaying renewed weakness, growth in 2003 is not likely to reach the modest 1.5 per cent rate forecast earlier this year. Output growth of 1.1 per cent is the current estimate for Japan in 2003. For Australia and New Zealand, growth in 2002 should be close to the rate forecast earlier in the year or fall short slightly. For 2003, the outlook is more uncertain with the balance of risks broadly neutral for the two economies with some potential on the upside.

Policy issues and challenges

ESCAP developing countries have still to regain their pre-crisis momentum

In the *Economic and Social Survey of Asia and the Pacific 2002* it was forecast that the developing economies of the region would collectively improve their growth performance in 2002 by about 1 percentage point to 4.2 per cent with a further acceleration to 5.4 per cent in 2003. However, at these rates of growth the developing countries of the region would still be a good 2 percentage points or more below the rates achieved in 1996. The loss of output implied by this shortfall translates itself into fewer jobs created in the economies of the region and, through lower tax yields, new pressures on government budgets. The immediate policy challenge therefore is to regain and sustain the pre-1997 momentum of growth in the region as a whole. As is self-evident from the earlier discussion, some subregions are better situated than others in terms of their level of dependence on external demand to sustain growth and in their ability to take appropriate measures at the domestic level. However, the general policy issues and challenges that arise are applicable *mutatis mutandis* to the region as a whole.

Higher growth is needed to continue with poverty alleviation in the region

It should be emphasized at the outset that sustaining the momentum of growth is necessary not merely for its own sake but to provide Governments with the resources to address emerging social issues and problems and to alleviate poverty and social distress progressively through the higher levels of employment that growth generates. Growth is also needed to help in the resolution of issues pertaining to corporate and financial sector reform as enunciated in the *Bulletin 2001/02* and *the Survey 2002*. Although significant progress has been made in dealing with these matters over the past five years, more decisive action would almost certainly be facilitated by an environment in which businesses, Governments and the public could all discern improvements taking place and reform efforts would cease to be construed as an ongoing form of penance. It has to be recognized too that in developing countries reforms are an essential, continuing process that needs to be securely anchored in a realistic framework of development and poverty reduction strategies.

Fiscal sustainability remains an important issue for policy

On the domestic front, given that public debt has risen in many countries, the fundamental question is the degree to which fiscal stimulus can be maintained over the medium term without running the risk of countries being caught in the debt trap – a situation where debt starts to grow faster than the means to service it. As discussed in the *Survey 2002*, the issue of fiscal sustainability arises in all economies including those where deficits caused by high public spending have historically existed for some time and public debt as a ratio of GDP has risen to a high level; it also applies to countries where rising public debt is a relatively new phenomenon.

There is no doubt that, with public debt in the region having nearly doubled from 29 to 52 per cent of GDP between 1996 and 2001, the question of sustainability is one that has to be posed for essentially three reasons. First, in a globalized world economy, financial markets are no longer comfortable with rising levels of public debt, especially if there is a possibility that some of it may have to be monetized. In countries where public debt is perceived to be rising unsustainably fast, access to external sources of finance, whether in the form of bank loans or bonds, is likely to be curtailed or be available only at a significant premium or both. Second, there is the danger that the public sector's increasing claim on resources will pre-empt investment funds for the private sector. The need for greater investment in public goods notwithstanding, the private sector is in danger of being "crowded out" and the overall level of investment efficiency lowered. Finally, long-term interest rates in the economy are in danger of being driven upwards. Thus, the fiscal stance has to be managed within a credible and stable medium-term strategy in which the overall level of debt is seen as remaining within prudential limits. Countries that allow themselves to be defined by images of instability or by reports of erratic changes in policies will have to face a costly risk premium in financial markets.

Lower interest rates have not always led to credit growth

The management of monetary policy is now also raising difficult policy choices for several economies.[4] Facilitated by lower interest rates in the developed countries and lower inflation, most economies in the region, with one or two minor exceptions, have been able to lower interest rates significantly from mid-2001 to mid-2002. In most countries, however, lower interest rates have not led to higher credit growth, thus far at any rate. The slow progress of bank restructuring and the large overhang of corporate indebtedness have clearly put a limit on the supply of new credit. Equally, there are problems from the demand side in the form of excess production capacity. Here, lower interest rates have, however, enabled many heavily indebted borrowers to restructure their debts and improve cash flow. But it

[4] Falling inflation automatically makes monetary conditions tighter even without an increase in interest rates. See Centre for European Policy Studies (2002).

is arguable whether corporate balance sheets have been strengthened in the process and new capital expenditures encouraged. The general view is that given the excess capacity still in existence new capital expenditures are unlikely to be undertaken in the months ahead and monetary easing may merely lead to the build-up of consumer debt.

Continued monetary easing in a low inflation, low interest rate environment is problematic

The fundamental problem appears to be that with interest rates already low further easing seems to produce only small additional effects. This has been seen in Japan, the EU and even to some extent the United States. This is because in an arithmetical sense, reductions of, say, 25 basis points or so when interest rates are already around 3 per cent or less will generate quite small savings in debt service. It is also because in economies where deflation has emerged and prices have started to fall, real interest rates can actually start rising. This can negate the effects of monetary easing completely. Indeed, with a falling price level, an apparently stable exchange rate can also perversely appreciate in real terms, thus effectively tightening policy further. Again, Japan is a prime example of this phenomenon. As of August 2002, in addition to Japan, China, Hong Kong, China, Singapore, Taiwan Province of China and Thailand were either experiencing deflation or were very close to it. It appears to be the case that once deflationary expectations have become established they are as difficult to shake off as inflationary expectations. Moreover, they tend to become self-fulfilling unless quickly reversed.

Monetary policy has to be recast if deflation is to be avoided

Thus, monetary easing is as circumscribed in the real world as is fiscal policy, and its stimulative effects could be nullified if a deflationary psychology takes hold. The monetary authorities have consequently to ensure that the current phase of low and declining inflation does not transform itself into a prolonged deflationary phase. Monetary policy has traditionally been built around the threat of inflation and the inflationary syndrome continues to exercise considerable influence in central banking attitudes. However, with inflation benign by historical standards there is a need to refashion policy priorities and recognize that deflation poses as much a threat to growth as inflation does. Monetary authorities need to be aware of the forces causing downward pressure on prices and to fashion an appropriate response to the phenomenon. It would appear that in countries pursuing an inflation targeting regime the objective should not be one of achieving a low rate of price increases per se but to achieve instead an overall environment of price stability in which relative prices have room to adjust freely. Inflationary pressures in developing countries are not purely monetary phenomena but are often the result of temporary supply bottlenecks. Too rigid an adherence to particular rates of inflation may not be conducive to the movement of factors of production between different uses in the economy.

On the external front, the size of the current account deficit of the United States along with prolonged turmoil in the financial markets poses a major challenge not just for policy makers in the United States but in all the more open, developing economies of the world. Present estimates suggest that the United States current account deficit is likely to increase from 4.7 per cent of GDP in 2002 to 4.9 per cent in 2003. In recent months, the United States fiscal situation has also deteriorated sharply and the budget surplus of 2.5 per cent of GDP forecast for the fiscal year 2002 only a year ago has been converted into a deficit of 1.6 per cent of GDP. On current assumptions the surplus is not likely to reappear before fiscal 2007. With continuing turmoil in United States financial markets these factors could presage a large-scale repatriation of assets held by foreigners in the United States, theoretically triggering a collapse in the dollar exchange rate with major knock-on effects on business and consumer confidence.

Correcting the United States trade imbalance poses dangers for the global economy

It has been argued for some time that the external imbalance in the United States is unsustainable, having risen from 1.5 per cent of GDP in 1995, a level at which it had stabilized in the previous two decades, to 4.5 per cent in 2001. Although alarmist talk regarding this deficit has tended to be consistently belied over the years, it is nevertheless true that the imbalance cannot be allowed to persist indefinitely. In that event, net external liabilities of the United States would rise to an extremely high level in due course and foreigners would become unwilling to hold United States assets. Some observers argue that the subsequent rebalancing of investors' portfolios away from United States assets could involve a huge readjustment of the dollar exchange rate. Clearly, if this were to happen suddenly it would generate enormous dislocations in world financial markets and the global economy.

The ESCAP region can contribute to global stability by maintaining commitments to trade liberalization

The first requirement hence is for countries in the region not to add to the uncertainty and possible dislocation in international transactions by taking restrictive measures in the areas of trade and financial flows. Regardless of actions being taken by other countries, countries in the ESCAP region should maintain their commitment to the agenda of liberalized trade and financial flows. In this regard, it might be a valuable gesture, with more than mere symbolic value, to advance the 2010 deadline that ASEAN members have committed themselves to for dismantling all tariff barriers. Equally, the ASEAN-China agreement to move to a free trade arrangement in 10 years could be given greater momentum through the "early harvest" tariff reductions in an accelerated tariff reduction plan. Such actions would signal intent on the part of the authorities to improve trading links between the countries concerned; for investors they could point to the massive size of the potential market and thus encourage early decision-making with regard to new investment expenditures. Trade should also be supported with efforts at improving trade facilitation and at streamlining payments mechanisms. In the latter context, tie-ups between Japanese banks and the Bank of China to facilitate trade between Japan and subsidiaries of Japanese companies operating in China are a case in point. Japan is also more favourably disposed towards regional trade liberalization having concluded a free trade agreement with Singapore and is currently in negotiations with the Republic of Korea and Thailand.

Falling stock markets partly reflect a loss of investor confidence

Financial market instability poses rather more complex issues. As of end-September 2002, the trade-weighted exchange rate of the dollar had depreciated by about 3 per cent. In the same period, stock markets in the United States had fallen by about a fifth, precipitating sell-offs virtually across the world, although markets in the region have escaped some of the downside pressures. Forecasts are notoriously unreliable where stock markets are concerned and speculating about the next 6-12 months is hazardous in the extreme. However, if the decline in stock markets is prolonged, it could feed back negatively on the global economy. In so far as the stock market declines reflect a correction of inflated values they are an appropriate and, indeed, welcome development. If, however, they are symptomatic of a loss of investor confidence they could herald a period of great uncertainty for both investors and managers in which investment decisions are postponed, corporate distress and bankruptcies increase and growth becomes less robust. The available evidence suggests that both factors are at work. There has been a drastic correction of inflated stock prices in the high-technology sectors, especially in telecommunications, but the succession of corporate scandals occurring in the United States suggests that investor confidence has also been gravely shaken. Indeed, the great fear for the next few months is one not so much of further price corrections in the stock markets but of a more pervasive loss of confidence extending to the household sector should artificial profits or new corporate scandals be revealed. Here, the region’s ability to take protective measures is much less. With greater globalization the world’s stock markets have become much more correlated, regardless of an individual country’s fundamentals, and it would be futile to seek to shield individual markets from instability occurring in the bigger, more international, markets. Nevertheless, countries in the region should seek to redouble their efforts at enhancing standards of transparency in corporate accounts and of corporate governance in the region and to take bold action should incidents of corporate malfeasance come to light in the future. As far as greater cooperation in exchange rates is concerned, the idea is worth exploring but raises complex issues. Implementation would appear to be some years away.

Countries in the region need to continue work on enhancing competitiveness

As countries of the region gear up to tackle their short-term challenges they must not lose sight of the need to sustain progress in the medium term to maintain and, indeed, enhance their competitiveness. Competitiveness has both macro and micro aspects and economic and non-economic determinants. The former lie in a prudential framework of macroeconomic policies that provide internal and external stability, while the latter consist of efforts to improve total factor productivity and enhance the absorption of technology by enterprises. Productivity, in turn, depends upon a mixture of investments in public goods, such as physical and social infrastructure in the diffusion of new technology in the economy and in the development of human resources. Strong public and private contributions are thus needed to build and sustain competitiveness.

Cooperative action to tackle common problems of the world economy is the way forward

Finally, as has been suggested in various forums, including in particular the International Conference on Financing for Development, held at Monterrey, Mexico, in March 2002, all countries, whether developed or developing, should strive to tackle the common problems of the world economy in a new spirit of partnership and remain engaged to that end. At the Monterrey meeting Governments of developed and developing countries agreed that through ODA the benefits of globalization could reach people living in poverty in many low-income countries. To this end, partnerships between ODA donors and recipient countries must be enhanced and donor assistance structured around the recipient country's own strategy for development. Such partnerships could be extended to other areas, such as containing financial market volatility.

Like the International Conference on Financing for Development, the World Summit on Sustainable Development at Johannesburg, South Africa, in August-September 2002 is a good example of greater cooperation between the developed and developing countries. While falling short of the expectations of many, the World Summit nevertheless signified that developed and developing countries are dependent upon each other to achieve durable progress in solving the world's myriad economic, social and environmental problems. While the Summit has enhanced awareness of environmental issues, it remains true that without much greater cooperation between countries even the limited agreements reached at Johannesburg will be difficult to implement.

However, cooperation does not require that large events like the Johannesburg summit be staged. Existing international and regional bodies provide forums and vehicles for cooperative endeavours to be identified and implemented. For their part, developed countries should be prepared to take more robust action in the areas of international financial flows, trade, debts and global governance. Developing countries, for their part, should make their domestic policies and institutional arrangements more development-friendly, to improve the utilization of ODA, to reduce poverty and to tackle deficiencies in the pursuit of these aims on the basis of "ownership". Effective ownership requires good governance at all levels of society based on realism and honesty, especially in matters concerning previous policy shortcomings in these areas.

As reported in the *Economic and Social Survey of Asia and the Pacific 2002*, through the Doha Development Agenda, WTO members agreed to launch a new round of trade negotiations. It is critically important for the global economy that the commitments made at Doha are honoured and no slippage occurs in the time frame for the completion of negotiations in different areas.

The policy agenda for the ESCAP region is little changed from the previous year

The overall conclusion for the ESCAP region thus consists of a reiteration of suggestions made in previous issues of the *Bulletin* and *Survey* to support sustainable growth by member Governments over the next 12-18 months and beyond: to speed up structural reforms to make their economies more competitive; to prepare for and manage globalization better by understanding the interaction between international and national policies and financial markets; to continue to deepen financial markets and reduce dependence on any one source of finance for development; to strengthen the formulation and implementation of policies, especially macroprudential policies; to enhance the quality of governance in both the public and private sectors; and to minimize conflicts of interest in the field of governance (Kharas 2002).

It is a truism that the course of events over the next 12 months or so will be conditioned not only by policies but equally by unforeseen events. Experience, however, suggests that flexible public policies, based upon a credible and realistic framework of expectations, can not only prevent adverse developments but can also cushion the impact on the economy of unforeseen events when they happen. Not all adverse developments, however, can be fully countered by policies and the constraint on resources is a datum for all economies, developed and developing, circumscribing the capacity of Governments to take corrective action in a timely fashion. But, as has been seen, good policies can contribute to mitigating the adverse effects of disasters, natural or man-made, and to a quicker recovery in their aftermath. The ESCAP region has displayed considerable resilience in dealing with the 1997 crisis and in meeting the challenges it posed, for the countries directly affected as well as for others, in both the economic and social fields. The 2001 slowdown provided another opportunity to fashion new policy responses to promote growth in 2002 and 2003 and for the region as a whole to resume its pre-1997 pace of economic and social development.

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II SOCIAL PROTECTION IN THE "NEW" ECONOMY

by Linda Low[1]

Greater uncertainty and risk associated with the new economy justify a reconsideration of social security systems in Asia

Technology, globalization, deregulation and competition have merged in a potent package as the "new" economy, bearing both hope and peril for developing economies. This paper examines the impact and implications of the new economy on social security and social welfare protection, highlighting Asian non-welfare States. Workers inevitably bear the burden of adjustment to globalization and the new economy despite overall long-term gains. Developed countries face a "race to the bottom" competing with sweatshop developing countries. There is no easy compromise on the correct level of labour and social standards with uneven, diverse socio-economic growth. Greater interdependence, integration and convergence of global and technology trends have rendered all economies more volatile and susceptible to exogenous factors, including contagion. Greater uncertainties and risks are inserted into national economies, which feed back and constrain domestic policies and goals. These effects, epitomized by the Asian crisis, encompass a social dimension as deep and profound as the economic aftermath. Idiosyncratic Asian social security and welfare systems warrant a rethinking in the same way that Western welfare State reforms are spurred by demographic and fiscal transitions.

This paper is meant to be provocative, identifying trends and ideas rather than aspiring to ready-made policy solutions or resolutions. The underlying premise of poverty alleviation and improving the economic and social welfare of workers is intrinsic to growth, as any worsening would impinge on economic efficiency and productivity. After a review of definitions and concepts of social protection, globalization and the new economy, their interrelationships and impacts leading into Asian issues, with policy implications, are outlined below.

The four components of social protection

According to the International Labour Organization (ILO), social protection is conceived as having four components, namely, social security systems (statutory employer-related benefits), universal social benefit systems (benefits for all), social assistance systems (poverty alleviation in cash and in kind for all in special need) and private benefit systems (employer-related or individual benefits) (ILO 1997: 5-6). Social security protects members of society through public measures against economic and social distress, the provision of medical care and the provision of subsidies to families with children (ILO 1998a: 8). Distress is caused by work stoppage

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or a substantial reduction in earnings resulting from sickness, maternity, workplace injury, unemployment, invalidity, old age or death of a wage earner in the family. Social security elements include social insurance, social assistance, benefits financed from general reserves of a country, family benefits, provident funds and employer provisions, notably workers' compensation and other complementary programmes. A social safety net ensures that each member of society facing destitution is provided with the minimum level of cash income, health and social services needed to lead a socially meaningful life (ILO 1997).

The role of the State in social protection is, however, politically conditioned

While individuals acting through markets are responsible for income maintenance and welfare protection, the State is the traditional provider of last resort. The State may either take a Bismarckian approach to social insurance, offering protection in the event of contingency, or adopt a Beveridgean response, acting directly on poverty through mutual aid and solidarity via non-contributory, universal benefits or means-tested and discretionary benefits, or some combination of the two (Spicker 1993). Social responsibility and social justice thus complement political democracy, including civil rights and liberties. In practice, the State intervenes on a continuum, from non-intrusive, market-supporting measures to central control in a welfare system. In consequence, the social market and the economic market distinguish between need and utility respectively. Politics may dictate government-knows-best provision instead of self-interested individualism, which impinges on affordability and choice. The welfare triad of State, market and family are functional equivalents and mutually substitutable in social policy for the public management of social risks (Esping-Andersen 1999: 36).

Models of the welfare State lie along a continuum

The welfare State incorporates universal social insurance to provide a minimum of social security as a constitutional right and inalienable component of citizenship, redistributes wealth and helps those in need (Zijderveld 1999: 10-13). Economically, it is a mixed system, based on a relatively free market for business while producing and providing collective services in the social sphere, occasionally through non-government organizations. The residual welfare State found in the United States of America, which takes responsibility for general welfare in a targeted manner only when the market and/or family fail, is at one end of the spectrum, limiting its scope to marginal and deserving social groups. At the other end, the European welfare State is universalistic, assuming responsibility for a broad spectrum of social services and having a highly organized and deeply institutionalized role in distributing these services, to which, in principle, all citizens are entitled. The Scandinavian system is the most comprehensive, intensive and extensive welfare State, aspiring to equality of the highest standard, not equality of minimal needs.

Competitive pressures in the new economy are forcing a hollowing-out of the welfare State

The welfare State has waned with the demographic transition of the post-war baby boom. Social security domains in poverty prevention, poverty alleviation, social compensation and income redistribution face new risks in employment and employability as structural unemployment has emerged as a new kind of poverty. A techno-economic paradigm of information and communications technology (ICT) and the knowledge-based economy (KBE) have created a new knowledge-elite class that favours free markets in this post-industrial society, characterized by globalization, decentralization, deregulation and privatization. Labour becomes the Achilles heel of globalization as the ideological underpinnings of social protection, national solidarity, social partnership and tripartism are undermined. There is a hollowing-out, downsizing and retrenching of the welfare and social State, an erosion of social citizenship and a return of unemployment, with jobless growth, greater labour market flexibility and deregulation (Mishra 1999). Labour market deregulation and flexibility in decentralized collective bargaining can lead to social dumping and a downward shift of wages and working conditions. Competitive cost considerations exert a downward pressure on social protection and social expenditure as Governments and corporations reprioritize budgets, taxes and profits. Simultaneously, the ability of national Governments to pursue full employment and growth through reflationary Keynesian policies has been undermined.

Labour and the State are weakened as jobless growth and globalization reduce bargaining power vis-à-vis capital

The balance of power shifts away from labour and the State to capital in two related effects, joblessness and a digital divide. Career paths are changed, with contingent and atypical work (Sherman and Judkins 1995). Microelectronics means joblessness in a simultaneous direct loss of employment and employability in globalized markets of transferable skills, technology and finance. Microelectronics reduces employment directly by substituting hardware and systems, restructuring, changing products and components, and fostering takeovers, mergers, bankruptcies and overseas competition. Microelectronics truncates time, cuts out layers of middle management, supervision, brokering and intermediation. New developments in flatter organizations and lean production lead to flexible manning, the need for multiple skills and the end of restrictive practices by trade unions. Ironically, the worker as consumer still cannot be summarily dismissed as Walter Reuther, president of the United Automobile Workers' Union in the United States once said, "Robots don't buy cars, Mr. Ford".

A digital divide yawns between the skill "haves" and "have-nots"

The digital divide affects the less educated, less skilled and vulnerable minority groups by age, gender or race. Knowledge becomes a "heterogeneous resource" as the knowledge content of goods and services like computers, telephones, aeroplanes or cars incorporates value added that changes traditional activities. In the old economy, people bought "congealed resources" in a lot of material held together by a little bit of knowledge while in the new economy people buy "congealed knowledge" with a large amount of intellectual content slipped into the physical commodity (Stewart 1997: 10-16). Multifactor productivity grows as technology is coupled with working smarter, increasing the divergence of labour utilization between old and new economies (OECD 2000). Creativity and innovativeness and not just technical skills and qualifications explain the difference between intellectual capital and conventional human capital.

The new economy, in the view of some, affects business cycles as ICT and productivity together with globalization change the short-run trade-off between inflation and unemployment. Diverse growth sources lead to gains from increasing returns to scale, network effects and externalities. Communications networks and Internet applications increase as more people are connected, entailing considerable spillovers, contributing to multifactor productivity and fuelling growth. ICT and productivity put downward pressure on inflation while increased globalization and competition keep wages and prices in check. Taken to extremes, these developments lead to belief in the myth, now exploded, of the end of the business cycle.

The new, non-industrial risk society fosters irrational sentiments and a backlash against globalization

Finally, an underlying premise of the volatile KBE is the parallel conception of a "non-industrial" risk society where both nature and tradition cease to understand and interpret radicalized challenges (Beck 1992 and 1998). In the age of risk, society becomes a laboratory with nobody responsible for the outcomes of experiments. Globalization, ICT, KBE and deregulation carry risks, with a loss of distinction between nature and culture as basic changes in the foundations of the nation State and sovereignty occur simultaneously. "Given" risks in fate, nature and tradition are distinguished from "manufactured uncertainty", where risk is produced as a consequence of scientific and political efforts to control or minimize them. "Organized irresponsibility" results if institutions and policies are confronted with these risks but deny their reality, as politicians are prone to do. Without the necessary compensation or control, risks and manufactured uncertainties set off dynamic challenges, which in turn may be translated into systemic risk and irrational sentiments, observed as a backlash against globalization.

Unemployment and poverty are the still visible social impacts of the 1997-1998 crisis

Turning to the Asian context, unemployment and poverty are visible social impacts of the 1997-1998 crisis, felt particularly by vulnerable groups such as women, children, the elderly and migrant workers. The poor suffer hunger and malnutrition. Social distress affects the elderly, the homeless, street ragamuffins and "economic orphans" from dysfunctional and disintegrated families owing to divorce, domestic violence, humiliation from job loss and even suicide. Children are deprived of school and as the only commodity of the poor may even be forced into crime or prostitution, a fate worse than child labour. Migrant workers, without any social security and welfare protection in the best of times either at home or abroad, face deportation. Labour markets across Asia have been integrated with increasing globalization and economic integration since the 1970s (Asian Development Bank 1998: 34). This may have eased domestic employment pressures, boosted national savings and the overall balance of payments through workers' remittances, but with a time bomb effect. Ironically, the human face of the crisis is reflected in the very success of a broadened East Asian middle class that evaporated in an "historical class plunge". Manual, production and office workers and middle-level management and professionals who became rich in the real estate and stock markets have now joined the urban low-income class.

However, social security networks remain underdeveloped in Asia as the lack of social dialogue deprives those in distress of a voice

A general lack of social dialogue exists in Asia, except in the Republic of Korea, where trades unions are relatively strong. Social distress carries no voice with inadequate safety nets, absence of democratic institutions and freedom of association (ILO 1998b). Asian social security networks, including those in Japan and the Republic of Korea, are appallingly underdeveloped and neglected. The financing of old age security and health care provisions and welfare protection issues, including coverage of migrant workers, requires an effective long-term institutionalized social network. Asian social security and welfare traditionally rely on individuals and families as communitarianism prevails in rural, agricultural settings, sanctioned by Confucian values and Asian filial piety. Industrialization, urbanization and modernization have denuded such traditional systems and values. The scope, expanse and elasticity of farming communities to absorb and protect extended families, kin and friends have been reduced. The urban poor cannot easily escape back to the countryside, where the rural poor may still have some land for sustenance.

Social security reform in Asia needs to be accompanied by financial sector development if the high domestic savings rates are to be translated into adequate social protection

Social security and welfare protection as public goods bear a rethink even if fully-fledged welfare States in the Western model are neither viable nor suitable in Asia. Mandatory publicly or privately administered savings ranging from pay-as-you-go to self-financed provident funds should be a minimum as individuals are myopic. Existing Asian systems are an informal, ad hoc hodgepodge, ranging from developed schemes for the army and the civil service, mostly colonial legacies, to stigmatized charity provisions by civic rather than civil society, to abject neglect for the majority. Although the social, economic and cultural environments in Africa, Asia, Latin America and the industrialized economies differ, all countries face some common social policy reform issues. Short-term objectives must be weighed against long-term social, economic and institutional effects and all face financial constraints. The high domestic saving rates in Asia belie the low mobilization, investment and utilization vehicles, implying that financial sector development must proceed in tandem with social security design and reform.

Growth fuelled by reliance on foreign investment and markets exposed the region to the forces of globalization and the new economy but the new social contract called for is hard to forge in the Asian context

Asia has to be globalization-ready not just by adjusting to a more open competitive environment in trade liberalization and deregulation, but also by preparing domestic industries, including State and indigenous enterprises, to face the entry of foreign competitors, notwithstanding any positive affirmative policy. Blaming globalization, especially speculative financial flows, for social and economic distress is reaching for excuses, as global interdependence and contagion are the costs of reliance on foreign investment and export-led growth. Graduating effectively, efficiently and quickly to participate and compete in the global economy is hard for developing countries with national agendas based on nationalism or ethnicity as in South-East Asia or with strong, visible government hands and State-business relationships as in the newly industrialized countries of the region. Democracy, political freedom and choice, welfare capitalism and an egalitarianism that balances equality and equity are not Asia’s strong suits. A new social contract in keeping with globalization and the new economy, with its emphasis on the tertiary sector, is hard to forge in Asia’s socio-political ethos and value systems. The challenges are no easier for Asia than for the developed industrial economies.

The State's ability to step up to the new challenges is undermined by the logic of international capital mobility

The dilemma lies in greater uncertainty and risk requiring more State-driven social security and welfare protection when the new economy calls for more neo-liberal, private sector-led cost competitiveness and profitability. Wage costs should not be weighed down by social security costs to be competitive, but poor labour and social standards and social dumping are undesirable. Tripartite social structures are of no avail as globalization strengthens capitalism in societies bifurcated into winners or losers. National interest and solidarity are lost when sovereignty is overrun by foreign investors and multinational corporations. The logic of globalization sets the tune to which developing economies dance, conflicting with the logic of the national community and democratic politics. Social policy becomes an object of contention between global capitalism and the democratic nation State (Mishra 1999).

Social protection receives little attention from ASEAN but is increasingly part of trade regimes under the World Trade Organization

Transnational social policy issues are addressed by some regional groupings, notably the European Union and the North American Free Trade Agreement. However, they are not discussed in the Association of Southeast Asian Nations (ASEAN) or ASEAN Plus Three. The preferred non-institutionalized ASEAN or Asian approach to globalization is fundamentally ad hoc, pragmatic and strategic and combines neo-authoritarianism with the market. Non-interference in domestic politics is not just the rule, but is part of the cultural etiquette. Whether it is the "residual" approach to social policy taken by international organizations with some powers of economic surveillance through granting loans and arranging financial assistance or the non-committal preference for non-institutionalism, Asian social security and welfare protection remain fundamentally weak and are squeezed further by the need to be internationally competitive. Minimalist social security policy is at best an adjunct to economic and social policy, not human rights under the United Nations or labour rights under ILO. Trading regimes directed by the World Trade Organization are, however, increasingly concerned with social clauses such as minimal labour and human rights as trade unions in developed industrial countries seek to limit unfair competition and social dumping.

Privatization can reduce public expenditure burdens but does not eliminate the role of the State in providing basic social and welfare protection

Privatization of social security is a seductive argument, promoted to lower the public expenditure burden, encourage self-reliance and respond to a more differentiated and individualistic demand in a post-industrial society (Esping-Andersen 1996: 26). Adverse selection in the annuity market requires the existence of fairly priced annuities, and increased welfare gains occur only by putting a larger segment of the population into this market by mandating the conversion of private retirement accounts into annuities. If privatization entails a shift of responsibility to companies, it affects international competitiveness, corporate profits and labour market flexibility. Even as a last resort, the State is morally responsible for certain basic social security and welfare protection even if individual responsibility is important. Granted that social insurance is still desirable with greater uncertainty and risk in the new economy, the preferred alternative would be defined contribution rather than defined benefit plans, similar to individual insurance schemes in Chile or the 401 (k) individual retirement accounts in the United States. Means-tested welfare State and income transfer programmes, which perversely create work disincentives and lead to a tax revolt, are lessons from the West.

Social justice must accompany increased growth and affluence if the gains of the working middle class in the region are to be safeguarded

In conclusion, whatever is missing in Asia or what is idiosyncratically Asian has to be addressed, urged by the destabilizing crisis and international standards and practices. Growth with affluence implies social justice, measured in the ability of citizens to meet basic needs and to take advantage of opportunities and life chances. It would be a pyrrhic victory if Asia attained growth, with higher labour force participation, but the working middle class was in danger of becoming an underclass. As Asia recovers, the new issues are more social than economic. With or without a welfare State, government intervention must mandate savings, regulate markets and commission private agents to produce financial and social security services complementary and supplementary to State- and employer-based provisions. Leaving it to individuals, families and communities to provide for social security and welfare protection is no longer viable or politically acceptable. Global trends portend unpredictability as to the probability and extent of risks occurring and an uneven distribution of the resulting damage. Private coverage of social risks is impossible, incomplete and insufficient, and yields inequitable outcomes given the imperfect ability to assess and measure risk owing to asymmetric information, the skewed distribution of damage and its probability of occurrence, and the myopic behaviour of people at risk. Market failure is a necessary but not a sufficient condition for government intervention; externalities prevail for social security as it is a public good in itself.

Parts of Asia are already confronting ageing populations. The post-war baby boom may turn into a "social security bust" if holistic policy reform is not undertaken in time, as experience elsewhere has shown (Aaron and Shoven 1999). In the final analysis, the misperception that globalization and the new economy are major constraints to national policy is due to the mistaken identification of global and national forces as competing in a zero-sum game rather than being complementary. The tendency to blame or to make excuses overlooks the positive, transforming impact, the improved capabilities and the new resources unleashed by globalization and ICT.

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III A NOTE ON UNEMPLOYMENT IN THE WAKE OF THE ASIAN ECONOMIC CRISIS AND SOME RESPONSES[1]

Preamble

The second half of 1997 saw the emergence of a severe economic crisis in a number of East and South-East Asian countries. Over a short period of time, some of the fastest-growing economies in the world came to a grinding halt. Output fell, unemployment increased, GDP contracted and the incidence of poverty multiplied.

Safety nets to protect the unemployed were not on the policy agenda during the years of rapid growth

The scale of the impact was enormous and the misery suffered by the people was overwhelming. Countries in East and South-East Asia in the pre-crisis years benefited from a situation where high economic growth, high employment levels and high social development reinforced each other. The designing of safety nets to provide a cushion to persons affected by sudden economic downturns did not feature prominently on the policy agenda. Suddenly hit by the crisis, countries had to design short-term programmes and policies quickly to arrest a rapidly deteriorating situation characterized by rising unemployment and loss of income (ESCAP 1998). In addition, efforts were undertaken to rejuvenate output and economic growth so as to increase the demand for labour in the long term.

The need for new programmes and policies to deal with the crisis led to drastic changes in the fiscal stance in affected countries

In the short run, Governments depended on the programmes and policies that were already in existence and expanded these to benefit affected persons so as to mitigate the consequences of the crisis. In the medium term, to enhance output and economic growth and to address structural issues, Governments implemented various fiscal stimulus measures, took steps to improve labour productivity and export competitiveness and adopted policies and programmes to strengthen the financial sector. To finance the implementation of both sets of measures there was a drastic change in the macroeconomic stance of the affected countries in that Governments known to be very conservative on the fiscal front allowed budgets previously in surplus to move into deficit. In the Republic of Korea, the ratio of the Government's budget balance to GDP became –4.2 in 1998 from the 2.2 per cent realized during the period 1994-1996. The equivalent ratios in Indonesia, Thailand and Malaysia were –1.7, –2.8 and –1.8 per cent respectively in 1998, compared with 1.4, 2.2 and 1.2 per cent during 1994-1996.

[1] Prepared under the supervision of the Development Policy Analysis Section, Development Research and Policy Analysis Division, ESCAP.

The aim of the present note is very modest. An attempt is made to discuss briefly the major short-term responses with country examples. Wherever possible, comments are made on their impact. Based on this, a perspective on a possible strategy for coping with unemployment and the associated effects is given at the end.

Overview

The crisis exposed the weaknesses of existing labour market policies and social programmes

The Asian economic crisis had an adverse impact on labour markets in the affected countries. The crisis also exposed the limited capability of national social safety nets and labour market policies to accommodate effectively shifts in the employment status of those directly affected. Labour market flexibility, which allowed real wages as well as hours of work to fall, helped in checking the aggravation in open unemployment to some extent. However, underemployment increased, as did the contribution of the service sector (of which a large part is informal) to the provision of employment. Increased unemployment and lower real wages led to higher poverty levels in the countries affected by the crisis. Although the existing government machinery in these countries was not fully equipped to deal with a crisis on such a massive scale, countries expanded and implemented several existing institutions and programmes to mitigate the negative impact of the crisis on the labour market. These included public employment information services, training and retraining programmes, public works programmes, unemployment benefits, microcredit schemes and credit programmes for small and medium-sized enterprises (SMEs). All these programmes were expected to benefit the unemployed, either directly or through the preservation of jobs. In addition to these, certain labour market policies were adopted to deal with the unemployment situation at least partially.

The impact of programmes to mitigate the adverse impact of the crisis on the labour market varied across countries

The success of the programmes in terms of their impact varied across countries. Public employment information services expanded in all the countries to assist the unemployed in finding jobs. However, only Malaysia and the Republic of Korea achieved some notable success through this mechanism. Training and retraining programmes were also started for the displaced and unemployed workers in all countries but these were very small compared with the extent of the need in each country. Only in the Republic of Korea did these programmes have a wide outreach.

Recent research by ESCAP evaluated the performance and impact of public works programmes, microcredit programmes, unemployment insurance schemes and SME credit programmes (ESCAP 2002b). The study, based on small-scale surveys conducted of beneficiaries of the programmes in Indonesia, the Republic of Korea and Thailand, concluded that persons benefiting from public works programmes, especially those with low levels of education, had experienced an income decline during the crisis. However, the public works involved hard manual labour, which limited the ability of women and the elderly to participate. In contrast, microcredit programmes were more successful in reaching women. Neither of the two types of programmes was found to have benefited (in any significant manner) persons who had lost their jobs in the formal sector in either Indonesia or Thailand.

The existing unemployment insurance scheme in the Republic of Korea was expanded in the wake of crisis and assisted a large number of people covered by it. Interestingly, incomes generated under most of these programmes (public works, microcredit and unemployment insurance) were not sufficient to cover the basic needs of beneficiaries. As expected, most of the sampled firms that had received credit on easy terms under the SME credit programmes had suffered a loss of business during the economic crisis.

Governments were unprepared to deal with the social consequences of the economic crisis

Capacity for designing and implementing employment generation programmes on a large scale was lacking in many of the crisis-hit countries partly because Governments had relied upon rapid economic growth in the pre-crisis period to provide employment and associated social protection. Governments were therefore unprepared to deal with the social consequences of the sudden eruption of the economic crisis. Many programmes were hastily designed and their implementation rushed, leading to a lack of coordination among the various government departments responsible. The importance of developing the capacity, at both the national and decentralized levels, to design and implement similar programmes in future is clear. Moreover, appropriate long-term social safety nets or protection mechanisms for use during normal times (to alleviate structural poverty) as well as during economic downturns need to be developed.

Trends in unemployment and other macroeconomic aggregates during the crisis

Of the countries affected by the economic crisis, Indonesia, the Republic of Korea and Thailand were the hardest hit, followed by Malaysia and the Philippines. Most of these countries were growing rapidly before the crisis broke out in 1997. As a result of the crisis, GDP declined by 13 per cent in Indonesia, 10.2 per cent in Thailand, 7.4 per cent in Malaysia, 6.7 per cent in the Republic of Korea and 0.6 per cent in the Philippines in 1998 compared with the previous year. The decline bottomed out the following year and positive growth rates subsequently resumed but the strength of the recovery varied widely among these countries (ADB 2002).[2]

Together with the decline in GDP, the sectoral composition of output underwent changes

Accompanying the sharp falls in GDP in 1998 was a change in the sectoral composition of output. The share of agriculture in GDP increased in Indonesia, Malaysia and Thailand, while the service sector declined in importance. The construction industry was the most seriously affected in all five countries and as a result its share in output fell. Agriculture also absorbed more of the labour force and its share in total employment increased in most of the countries, at the expense of manufacturing and construction. The largest increase occurred in Indonesia, where the sector's share of the total employed labour force rose from 41 per cent in 1997 to 45 per cent in 1998. Interestingly, employment in the service sector increased in most countries, despite the fact that its share in GDP decreased in some of them. This suggests that many persons losing jobs elsewhere in the economy sought

[2] Most of the other data used in this section are also drawn from this source.

employment in this sector, increasing the competition for available jobs and putting downward pressure on wage rates. One would expect an expansion of the informal sector under these circumstances, especially in terms of its contribution to employment.

Unemployment rose from historically low rates

Prior to the economic crisis, all countries enjoyed low unemployment rates with the exception of the Philippines (see table below). As economic activity contracted sharply, the unemployment rate started to rise. For example, in Thailand the unemployment rate was around 1 per cent in 1996. It rose to 3.4 per cent in 1998 (an increase of over 200 per cent) and 0.8 million jobs were lost in the wake of crisis. Similarly, in the Republic of Korea, the unemployment rate rose from the comparatively low figure of 2 per cent in 1996 to 6.8 per cent in 1998, adding around 1 million to the pool of the unemployed. Unemployment also increased in the other three countries but less sharply. Although some countries witnessed a reduction in unemployment rates in 2000, these rates continue to remain higher than those prevailing before the crisis.

Table. Unemployment rates, 1990-2001

(Percentage)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
Indonesia	7.2	4.9	4.7	5.5	6.4	6.1	8.1
Malaysia	3.1	2.5	2.4	3.2	3.4	3.1	3.6
Philippines	8.4	7.4	7.9	9.6	9.4	10.1	9.8
Republic of Korea	2.0	2.0	2.6	6.8	6.3	4.1	3.7
Thailand[a]	1.1	1.1	0.9	3.4	3.0	2.4	2.6

Source: Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2002* (Manila, ADB, 2002).

[a] The World Bank has estimated that the unemployment rate would be much higher if transient workers with occasional jobs were treated as unemployed (Economist Intelligence Unit 1999).

Another adverse impact of the crisis was that underemployment increased. Many of those who could not retain full-time jobs were able to work for fewer hours. For example, in Thailand, underemployment rose from 1.7 per cent in 1977 to 2.8 per cent in 1998 and further to 3.6 per cent in 1999 (World Bank 2000).

The fall in real wages had the most acute and widespread impact

The most acute and widespread impact of the Asian financial crisis on the labour market was the fall in real wages as inflation quickly eroded their nominal value. For example, while nominal wages continued to rise in Indonesia, real wages fell by 30 per cent between 1997 and 1998. In Thailand, the fall in real wages accelerated from about 1 per cent in 1997 to around 7 per cent in 1998. Real wages decreased by approximately 10 per cent in the Republic of Korea in 1998 but the decrease was more contained in both

Malaysia and the Philippines. Labour markets displayed a great deal of flexibility in the sense that even nominal wages in manufacturing in the Republic of Korea and Thailand fell in the wake of crisis, which helped to limit the incidence of unemployment (ILO 2002a).

The incidence of poverty increased in all countries

Rising unemployment and underemployment coupled with high inflation and falling real wages quickly transformed the economic crisis into a social crisis. The incidence of poverty increased in all the countries, with Indonesia being the hardest hit: 18.2 per cent of the population were classified as being poor in 1999 as compared with 11.3 per cent in 1996. In Thailand, the incidence of poverty rose from 11.4 per cent in 1996 to 13.0 per cent in 1998 and again to 15.9 per cent in 1999. In the Republic of Korea, the incidence of poverty among urban workers' households increased from 3 per cent in the fourth quarter of 1997 to 7.5 per cent in the third quarter of 1998 (ESCAP 2002a).

Employment-related programmes and measures

The crisis-affected countries implemented various programmes and measures to check the spread of unemployment and minimize hardship. These included public employment information services, training programmes, public works programmes, unemployment insurance schemes, microcredit and SME credit programmes, as well as other labour market policies.

Employment information services grew rapidly

Employment information services were in operation in all countries well before the Asian crisis as part of the normal battery of policies and programmes to create jobs, place job-seekers and offer employment counselling and guidance services. In some countries, for example, the Republic of Korea, the public employment information service agency is also responsible for the registration and administration of unemployment insurance benefits. However, the crisis brought into the limelight the need to use these instruments to facilitate re-employment of thousands of laid-off workers. As a result, public employment services have been strengthened considerably in all crisis-affected countries.

In the Republic of Korea, the Government expanded the number of public employment services agencies from 52 in 1997 to 134 in 1999, leading to a considerable increase in the number of people finding jobs through them. A nationwide network of job information centres was also established, providing job-seekers with information and services on vacancies and unemployment benefits. The Government also relaxed the regulation for private placement agencies, which resulted in an increase of the number of private agencies. In Malaysia, public employment agencies were reported to have successfully found jobs for most of the workers affected by the massive job retrenchment due to the Asian crisis (Islam, Krishnamurty and Puri 2001).

The Internet has become a powerful and inexpensive tool for public employment information agencies

In most countries, public employment information services have been strengthened through the use of modern information and communication technology. The Internet has become a new, powerful and cheap tool for posting vacancies and placing job-seekers. An example is the Philippine PHIL-Jobnet, an automated job and application matching system that aims to fast-track job search for seekers and employers. Public workstations have also been installed in 43 regional offices in the Philippines for clients without direct access to the Internet. In the Republic of Korea, a similar system called Work-Net was also established.

In Thailand, a programme dubbed "The Candlelight Measure" under the Unemployment Alleviation Action Plan was adopted in December 1998 to help unemployed graduates to find jobs through a massive employment information dissemination campaign and the promotion of postgraduate studies. About 25,000 Thai graduates benefited from the programme. The crisis also led to the establishment of employment service centres to coordinate public and private employment services better. Furthermore, Thailand's labour force survey is now conducted on a monthly basis rather than three times a year as before the crisis.

The Government of Indonesia also recognized the need to upgrade its public employment information services to respond better to the crisis. A country report presented at a recent ILO meeting concluded that Indonesia's 174 district public employment services failed to produce much-needed labour market information during the crisis (ILO 2002b). This failure was attributed to lack of resources and inefficiency in obtaining and disseminating vacancy information. Increased funding and human resources development were sought.

The importance of strengthening public employment information services in the wake of the crisis was raised repeatedly at regional meetings organized by ILO between 1999 and 2002. There is now a consensus in favour of comprehensive public employment services to enable all economic agents in the labour market, i.e., employers, employees, job-seekers and Governments, to be better informed of the current employment situation and likely changes, so as to be able to respond quickly. This would make a closer match between labour supply and demand possible.

Public works programmes that had been phased out in some countries were revived

The main objectives of public works programmes were to generate wage employment for the unemployed and create economic infrastructure. For example, the activities undertaken in Indonesia during the crisis included construction or repair of village roads, construction of public markets and small shops, cultivation of useful plants on unutilized government land and construction of fish ponds for culturing marine fish. It is interesting to note that public works programmes were phased out in the country in the early 1990s as the labour market tightened. Their revival in 1997 in the wake of the crisis and further expansion in 1998 led to the coverage of large parts of the country by these programmes. In the Republic of Korea, public works programmes generated 440,000 jobs in 1998 and nearly 1.2 million jobs in 1999, providing work for around 70 per cent of the country's unemployed in 1999 (Islam, Krishnamurty and Puri 2001). The Government of Thailand also launched similar programmes, mainly utilizing external funds.

In many countries, training programmes had limited success

The crisis exposed a number of weaknesses in the public training and educational systems in many countries in the region. Foremost was the lack of training programmes for displaced or retrenched workers, which necessitated the setting-up of special measures and programmes to address this issue. The Government of Malaysia, for example, established a Human Resource Development Fund, a training grant for workers and those who were retrenched in order for them to obtain new skills and enhance their employability. Training grants were also given to unemployed graduates and school-leavers. In the Philippines, the Government provided training for workers affected by the crisis in the informal sector and rural areas in order to improve their income-earning potential and chances of being self-employed. Indonesia, the Republic of Korea and Thailand also implemented similar programmes for labour in response to the crisis.

In most countries, training programmes achieved limited success because the number of workers trained was very small in relation to the numbers displaced. The training programmes were more successful in the Republic of Korea, where some 362,941 persons, representing approximately a quarter of the unemployed in 1998, benefited from the training programmes. This success was attributed to an increased budget and the provision of unemployment benefits to the trainees. It should be noted that in times of an economic crisis survival becomes the priority of unemployed workers rather than enhancing skills through training programmes. Therefore, the provision of a subsistence allowance to displaced workers could serve to attract them to training and retraining programmes.

Private agencies are playing an increasingly important role in training

In all the countries, there has been an increase in the number of private agencies providing training for unemployed and displaced workers. Private agencies provided paid services to train workers seeking jobs locally and abroad. Better coordination between public and private training institutes could help in meeting the needs of workers. Moreover, it is important that public training programmes be demand-driven and formulated in consultation with the private sector.

Attention to training programmes in the wake of the crisis has revealed a number of important lessons. This includes the realization that the benefits of globalization can accrue only if an economy has a skilled labour force that can adapt to the changing demands of the global marketplace.

Credit programmes generated employment

Microcredit programmes provide small loans to beneficiaries for income-generating activities. The microcredit programmes in Indonesia provided soft credit at low interest rates, through a simple and quick procedure, to individuals organized into groups. The Government of Indonesia also required commercial banks to set aside a percentage of their loans for small borrowers. In Thailand such loans were provided either to groups or to individuals. To qualify for a loan, a project proposal with clear objectives was required, and proposals were to be reviewed and selected by relevant committees. In the Republic of Korea, credit was provided to unemployed professionals for self-employment and in another such programme training and start-up loans for small businesses were combined.

In the wake of the economic crisis, financing for SMEs from commercial banks and other financial institutions dried up, threatening their survival and adding to the risk of rising unemployment. Special loan schemes for SMEs were introduced in some countries, particularly the Republic of Korea, to help in job protection. In 1998, Malaysia launched a fund for small-scale entrepreneurs.

The unemployment insurance scheme expanded in the Republic of Korea

Among the countries directly affected by the crisis, only the Republic of Korea had an unemployment insurance system in place prior to the crisis. The scheme, which was launched by the Government in 1995, covered firms with more than 30 regular employees. In response to the economic crisis, the coverage was expanded to include firms with more than five regular employees. In October 1998, the coverage was expanded further to all workplaces, including firms with temporary workers. The programme covered 5.3 million workers (27 per cent of the employed labour force) by the end of 1998. Moreover, the minimum benefit was raised to 70 per cent of the minimum wage. In 1997, prior to the economic crisis, the number of beneficiaries was 15,000. By 1999, as a result of the economic crisis and the expansion in the coverage by the scheme, the number had risen to 441,000.

Labour market policies for dealing with unemployment were experimented with

During the crisis Governments adopted a number of additional policies and measures to protect existing jobs and create new ones. The provision of incentives for employers was an effective tool in maintaining existing jobs or minimizing lay-offs. These incentives took the form of subsidized credit, to improve liquidity and avoid bankruptcy, and wage subsidies. Such mechanisms have been employed to a significant extent in the Republic of Korea. Depending on the size of the firm, subsidies equivalent to between one half and two thirds of wages or allowances due to workers are paid for a maximum of six months. Other measures for protecting jobs were temporary shutdowns, reduction in working hours, training of redundant workers, giving paid or unpaid leave to workers, and dispatching or reassigning workers. In 1998, a large number (1,896) of firms received employment maintenance subsidies, covering a total of almost 800,000 workers. However, the scheme was rather costly and did not guarantee worker retention by firms.

The Government of Malaysia introduced retrenchment guidelines in August 1998, which forced companies to retain workers instead of resorting to retrenchment. These measures included retraining workers, cuts in pay, temporary lay-offs, voluntary separation schemes and the introduction of flexible working hours and part-time employment. From August to December 1998, some 759 employers resorted to pay cuts to save 22,719 workers from losing their jobs. The Government also proposed reducing workers’ contributions to the Employment Provident Fund from 11 to 9 per cent. This proposal was strongly opposed by the trade unions, resulting in a compromise whereby the reduced contribution was made optional. The Government also implemented a cut in allowances given to civil servants and in the contribution required of foreign workers to the Employment Provident Fund commencing 1 August 1998.

Thailand employed an action plan for unemployment relief. The following measures costing 61.4 billion baht (roughly US$ 1.5 billion) were expected to generate about 1.5 million jobs: (a) provision of cheap consumer products; (b) maintenance of employment levels in the industrial sector through reduction in social security contributions and production costs, increase in liquidity and foreign investment, and promotion of exports; (c) stricter controls on illegal immigrant workers, preserving around 300,000 jobs for local workers; (d) strengthening exports of labour; and (e) promotion of a rural and agriculture-based economy to attract workers back to the rural areas.

A perspective on strategies for coping with unemployment during an economic crisis

Strategies for coping with unemployment should be country-specific and based on a package of measures that make use of local institutions

Governments of affected countries instituted a variety of programmes and measures to cope with the unemployment situation during the Asian economic crisis. Not all countries have had equal success with these measures in mitigating unemployment, and measures effective in one country were not so in others. Institutions responsible for designing and implementing programmes were not developed to the same extent in all countries. The levels and strategies of development were also unequal and there were important structural differences, which had implications for the choice of policies and programmes. For example, an unemployment insurance system was available and usable in the Republic of Korea as the informal sector of that country is small in comparison with the others. Against this background, strategies for coping with unemployment in general, and during economic crises in particular, should be country-specific, based on a package of programmes and measures innovative enough to exploit the comparative advantages of local institutions based on the culture and traditions of each country. Community groups, self-help groups and family groupings could be part of these strategies. In addition, flexibility in the fiscal stance to permit the adoption of expansionary fiscal policies, for rejuvenating domestic demand and increasing growth in employment and GDP, and to finance social protection programmes during crisis periods could be an additional element in these strategies.

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IV A PERSPECTIVE ON GOOD GOVERNANCE[1]

"No matter how thin you slice it, there are always two sides" – J.C. High Eagle

If you want to know your past, look into your present conditions.
If you want to know your future, look into your present actions – Anonymous

Introductory remarks

Good governance has become a fashionable catch phrase in the aftermath of the financial and economic crisis in East and South-East Asia. Two perspectives are at stake in this context. First, the absence of good governance has been perceived as a major cause of the crisis, and the second prognosis is drawn by inference, namely, that good governance is imperative for durable development.

The 1997-1998 crisis has renewed focus on public and corporate governance …

Since July 1997, numerous writings have appeared and meetings have been convened with a focus on the excesses as well as the blemishes in public and corporate governance in this part of the developing world. In the process, a litany of recommendations of varying degrees of ingeniousness has been advanced for the post-crisis adjustment and reform of policies and institutions and for the revamped process of monitoring and enforcement. There should, indeed, be few excuses for the revealed imperfections and inadequacies in governance whether or not they are embodied as "corruption, cronyism and nepotism". However, the prevalence of preventive rules and prudential regulations is not sufficient, in itself, to raise the standards of governance and/or to ensure good governance in the public and private sectors.[2]

[1] Prepared by N.V. Lam, Chief, Socio-economic Trends Analysis Section, Development Research and Policy Analysis Division, ESCAP.

[2] This is clearly shown once again in several developed countries which have been advocated as a model for emulation in corporate regulation and governance, including the protection of minority shareholders. Nevertheless, a spate of massive corporate disasters in those regulatory bastions, due largely to bad governance, has created in their wake a substantial adverse impact on financial and business confidence, and on human welfare itself. A common concern in the current atmosphere is the restoration of trust which, itself, implies the existence of shared values and accepted standards, compliance with the set rules of the game, and full disclosure of transparent information.

… as a positive force for equitable growth and transformation

That good governance is an essential ingredient of durable development is not deniable, especially if it helps to promote “entrepreneurial capitalism” and, at the same time, rein in market capitalism of the “Wild West” variety. Indeed, a sobering thought in this context is the sustained, pre-crisis record of high economic growth and rapid social advancement achieved by the newly industrializing economies in East and South-East Asia. Such a “miraculous” performance as exhibited by these crisis-affected economies over the past three decades or so was unmatched and is likely to remain unmatchable globally. It has also changed postulates and shaped perspectives on development economics with some prominence being given to the so-called (East) Asian values and development-oriented governance or a “development State” as a positive force for economic growth and social transformation (more later).

Defining dimensions and limitations

Good governance entails full accountability to stakeholders …

Basically, good governance is predicated on full accountability to stakeholders (e.g., workers, shareholders, persons on fixed income, various social segments or strata and so on) in the exercise of mandated activities and functions by all concerned, whether they be central or local Government, managers of State and business enterprises, or civic and civil society organizations. It thus implies an informed, pluralistic and involved society but with shared basic norms, standards and aspirations. As such, good governance is clearly not without context; nor is it value-neutral. “Local contents”, colours and nuances matter. However, there are in practice few, if any, cost-free short cuts and ready answers to sustaining good governance, which, in the absence of optimal solutions, embodies a process of trial and error and a choice among trade-offs. Nor are there precise and uniform prescriptions or magic bullets in fostering economic development, social citizenship, political socialization and changed mindsets. Furthermore, standards of governance do not necessarily rise simply because of outside intervention, whether or not such intervention is delivered with judicious tact and sensitivity, or accompanied by generous measures of material goodwill.

… and implies equity in access and participation as well as full disclosure of information

Characteristically, good governance requires the equitable participation of all stakeholders in the design and formulation of policies and institutions that affect them, or at least a majority of them at any given time. In addition, there has to be a fair attribution to all stakeholders of the fruits as well as the burdens and mistakes of development. Moreover, good governance is predictable: there exists equal protection, plus non-discriminate and non-retroactive treatment, for all in the enforcement of laws and the application of regulations. Transparency is essential, too. Full disclosure of information is a sine qua non for confident interactions between individuals or groups. It is also a prerequisite for an objective, systematic and timely assessment of public or private governance and its stated outcomes. Indispensable in all these regards is strict observance and enforcement of common norms and recognized benchmarks.

In practice, good governance is severely tested by conflicts of interest …

As is evident in practice, however, the "proper" exercise of entrusted power and responsibilities is neither that straightforward; nor are the outcomes of good governance that clear-cut a proposition. At one level, the internal "boundaries" are not fixed at the margin and conflicts of interest (elegantly termed the moral hazard problem) are inherent and unavoidable. Government and civil society members are actively involved in a wide range of competing business and other activities, not least in the provision of social facilities and services. Private firms "sponsor" civil society organizations and candidates for government offices; in varying degrees of subtlety, they also "shade" public opinion through multimedia outlets. Individuals can wear several hats at the same time, often as both "judge and jury", promoters and beneficiaries, or controlling shareholders and corporate managers. The rent-based, cosy ties between business and politicians, also known as the "military-industrial complex" and "crony capitalism", are not confined exclusively to the old West or the new East; nor is greed in whatever shape or expression it is manifested within institutional and corporate hierarchies, or cross-culturally.

… by shifting power centres and loyalties, and the deepening complexity of growth and change …

At another level, boundary stakes are moved and shifted through interdependent economic growth, socio-political change, technological advances and the manufactured risks and organized irresponsibilities inevitable in most human systems and organizations. On the one hand, diverse groups of domestic constituencies and stakeholders are normally linked to equally disparate power centres with a shifting interface of converged interests. In addition, such constituencies and linkages have increasingly assumed an international character, reflecting the upward trends in extranational interaction of both an economic and non-economic nature. Yet the global community remains fragmented and divided long after the disappearing Cold War. On the other hand, transactions within and across borders have snowballed, often at breakneck pace and on a real-time basis. In addition, they have embodied greater knowledge, creativity and technological sophistication while also displaying significant volatility and contagious ripple effects.

… by the strains and stresses on institutions and capabilities, and the constraints from "leaner and meaner" Government …

All these have added further wear, tear and fatigue to existing frameworks, institutions and capabilities in the public and private sectors, including those underpinning the prerequisites of good governance itself. Indeed, the higher vulnerability stake, in terms of both economic uncertainties and social risks, has not often been matched by a broadening of the space and scope for domestic policy management and manoeuvre in most developing economies.[3] Government has become "leaner and meaner", an almost universal reorientation in development policy since the late 1980s, to minimize resource leakages and a soft budget constraint. By accident or default, however, social policy and social protection tend to become a casualty, through both downsizing and hollowing out. But an adequate and accessible supply of broad-based and competent social infrastructure and

[3] In another context, the granting of generous managers' share options has not solved the "agency problem". Likewise, the availability of big (managers') bonuses and huge (advisers') fees for pulling off mega-deals is not reflected by the rather undistinguished economic record of many completed mega corporate mergers and acquisitions.

institutions is a prerequisite for, among other avenues of incentives and progress, the timely and effective internalization of social gains as personal returns.

… and by the many challenges from openness and deregulation

Meanwhile, a correspondingly larger and more deregulated role has been assumed by or given to private businesses and capital, both domestic and transnational. That this is an expected or natural imperative in development and transformation under market capitalism does not make the transition and sequencing processes any less complex and time-consuming. In hindsight, the financial and economic crisis of 1997-1998 in East and South-East Asia reflected, in part, a stumbling block in transition even for high-performing economies with the strongest leadership, administrative capabilities and outward orientation in the developing world. There is then another disturbing complication, namely, that cross-border transactions are not always "civil" in nature. Drug and arms smuggling, human trafficking, money laundering, counterfeiting and terrorism activities are not inventions of the high-tech, late twentieth century. However, the scale and incidence involved in such un-civil transactions are perhaps greatly more insidious and pervasive than their counterparts throughout history.

Other major issues for good governance have a social underpinning and an intergenerational dimension

Moreover, several other systemic issues for good governance are still to be resolved; and these (multidimensional) dilemmas are no easier to resolve in the new East or in the old West. A "natural" tension has long existed between efforts to sustain a society aspiring to the highest standards of human welfare and the promotion of privately-centred, risk-taking business activities, initiatives and innovation. Likewise, a balance has yet to emerge between the relative security of employment (and by extension, human dignity) in a kinder and gentler business environment and corporate governance devoted solely to a single-minded pursuit of short-term profit maximization. The former has to be funded or mutualized in part through employees' forced savings and lower returns on capital while the latter tends to carry with it opportunities for enrichment for some and demoralizing uncertainties and insecurities for many. Furthermore, public and private governance has too often failed to make adequate provision for the overlap between current necessities and future requirements within and across interdependent economies, the intergenerational sustainability of development.

As such, governance is often compromised by trade-offs and expediency

The net result is that consensus-building on major issues has often proved so intractable that convenience, opaqueness, exclusivity and expediency are "the name of the game", along with the skewed distribution of benefits and burdens. This may well be regarded as "the art of the possible". Nevertheless, the economic and social trade-offs thus implied can erode an important portion of GDP in the longer term. Curiously enough, justice may be blind towards race, religion or riches in an environment of good governance. Institutionally, however, the maintenance of "justice" and the (egalitarian) balancing between access and equity for the average "Citizen Kane" have become overly time-consuming, complicated and costly. And so is the acquisition and pursuit of knowledge and skills, the quest for public office or the incubation of a culture of accountability.

Meanwhile, the vulnerable socio-economic segments remain appreciably large in many economies, both developing and developed

Concerted efforts have been made to uplift the socially, economically and politically disconnected, who are, almost as a rule, not well or adequately represented. Nevertheless, these vulnerable and marginalized groups (whether in terms of wealth, skill, gender, ethnicity or age) have remained stubbornly large in many countries on both sides of the development spectrum. The perceived inequity in access and participation, in accountability, in the skewed patterns of development and distribution, and in intergenerational sustainability have given rise to a multitude of single-issue civil society organizations. Increasingly, such advocacy groups have also operated at an extra-territorial level. This is a trend which helps but has also complicated and hindered the process of good governance and the quality of its outcomes.

A level playing field is yet to be ready

Famously, the playing field is not level. For good governance will facilitate, but by no means guarantee, the emergence onto the domestic and global arena of competing players and actors who are actually provided with equal opportunities or endowed with comparable strength and capabilities. And this leads to another set of critical, but even woollier, issues of an international nature.

Old issues, new agenda

Global governance is tried and tested by long intractable issues …

Blurred territories, moving markers, role versatility and the absence of shared values in action, if not in principle, have created far-reaching difficulties for global good governance as well. Ideas, innovations, human resources and development finance can now be packaged, transmitted and relocated with relative ease across frontiers. However, the borderless movement of natural persons and equity of access remain intractable, notwithstanding the continuing goodwill and understanding shown in several parts of the global village. It is an issue as intractable as the "adverse selection" characteristic of North-South private capital and technology flows and the incidence of the South-North "brain drain" plus the sizeable cross-border flow of largely unskilled labour for largely manual jobs or menial occupations.

… and diverging perceptions and practices

More narrowly, standards and benchmarks are certainly perceived and set differently by peoples and countries at different stages of development and with different socio-historical legacies. And this applies not just to the norms and conditions concerning employment, labour relations and amenities in the workplace, the eco-friendliness of traded products and production processes and, for that matter, the extent of political conformity and steerage by Government. But one cannot have it both ways.

Trade is mutually gainful but obstacles remain …

It is not that the great virtues of openness and tolerance (including through policy liberalization and administrative deregulation) and of freer trade and investment have not been well appreciated, and some "loss of autonomy" accepted, by interdependent economies and enterprises within the developing region. It is also well recognized by them that the sustainability of growth is predicated on continuous productivity gains over time, and not on the (competitive) undercutting of real wages or on pricing productive assets below their renewal or replacement costs. There is, however, a common perception among developing countries that the "goal posts" have often been moved and changed by the shifting calculus of the external political and social economy. In particular, stubborn obstacles have remained in the way of their potential exports and the equally stubborn debt trap has sapped the potential for growth in many poorer economies. By and large, ours has become a world which is much richer materially but also less generous with aid and technical assistance, whether conditional or untied.

… while collective action is not always distinguished by a common position as regards trade-offs

Meanwhile, the revolution in information, communications and transport technologies has helped to truncate the ethnic, cultural, geographical and political divides. Whether natural or human-made, prosperity or disasters nowadays can hardly, if at all, be split into and fenced off within isolated, localized fragments of affluence, suffering and instability within domestic regions or national frontiers totally shielded from the coverage and commentaries, whether balanced or intrusive, of the world's high-tech multimedia and watchdogs. Collective action is needed for a better and more equitable world, and for meeting higher human aspirations under the altered conditions and circumstances in our times. Yet it does not help that such action has often become amorphous and tenuous, in part, because of the lack of "universal" standards and common norms leading, in turn, to the conspicuous absence of consistency and persistency in action. Furthermore, there are many issues and prerequisites, as yet unresolved collectively, to ensuring due accountability in pressing matters ranging from third-party injury (also known elegantly as collateral damage) to the protection of the fragile ecology and endangered species.

The distribution gap has apparently widened within the global community

In addition, the daunting gap between the haves and the haves-not (the so-called issue of marginalized economies and vulnerable groups) has posed another formidable challenge to global good governance. There is simply too huge a number of people across the globe who remain disenfranchised in income, in digital connectivity, in cutting-edge knowledge and innovation, in education and learning (plus access thereto), etc. A sharp contrast in this connection is the seemingly unfathomable net worth of the wealthy and the disproportionate influence of massively huge corporations in industrialized countries. Such personal or corporate riches are far greater than the combined national incomes of a very large number of poor countries in any one year and, for that matter, of the very large majority of individuals living in these same industrialized countries as well.[4]

[4] Those outcomes are far different from the postulated, long-term convergence of international income levels through globalization and technology transfers so forcefully put forward by trade economists. They are also far different from the standard bell-shaped curve of relative equity in domestic income distribution so beloved by statisticians. Some of the composite indicators of inequality in terms of income, gender and ethnicity within the global community reported by UNDP in 1998 are telling. For example, the income gap between (the top and bottom one fifth of) the world's richest and poorest was 30 times in 1960 and 82 times in 1995. Disturbingly, such income polarization has become sharper since the early 1980s. The richest 225 persons in the world had a combined wealth equivalent to the annual income of 47 per cent of the global population (totalling some 2.5 billion persons). The three wealthiest persons had assets exceeding the combined GDPs of the 48 least developed countries in the mid-1990s.

All in all, a sense of disenfranchisement is felt by many

The uncontrollable forces of globalization and "global big business" in trade and technologies, and the seemingly unsustainable patterns of development and distribution have generated simmering fears, discontents and a sense of disenfranchisement that have permeated across several socio-economic strata within the global community. All these undercurrents and cross-currents are behind the recent upsurge in economic, social and ecological backlash which has marred the once clubby meetings of several multilateral agencies as well as of representatives of the richest and most powerful economies in the world.

The 1997-1998 crisis was a mutual failure of fundamentals …

Closer to home, the current Asian crisis and its aftermath can also be viewed as the destructive after-tremors of a cultural shock in an interdependent environment of imperfect governance, dissimilar mindsets and conflicting agendas, whether hidden or revealed. In particular, the rationality of the so-called "animal spirits" is not value-free; and professional successes and investment returns have been defined, understood and propagated all too narrowly, all too technically and all too impersonally. But it takes "two to tango", and the massive "round-tripping" of (short-term) external capital will simply cause an unserviceable shock, regardless of whether such an action is rational and necessary for a manager of external funds to share in a piece of the profitable action (herd-instinct exuberance) or to preserve share owners' equity value (self-centred panics).

… with devastating, but skewed distribution of, damage to third-party and long-cemented relationships

And the result is unprecedented, contagious damage wrought on hard-earned economic progress, the communal fabric and social stability of all and sundry, including well managed and governed (but indebted) enterprises and economies. Third-party collateral damage has been devastating, particularly for the poor and more vulnerable social groups. The crisis has highlighted once again that the insidious tyranny of dominant positions and blatant business opportunism are just "par for the course". Indeed, "robber barons" are not confined just to the new East or the old West; nor are the free-riders and cynical manipulators of all shades and sizes. The crisis has also exposed the fragility and impermanence of long-cemented relations and commercial partnerships, linkages founded on mutual material benefits but often (although not always) potentially denuded of compassion and higher values. Countries and corporations are thus stitched onto a cross-cultural patchwork of shifting alliances and convenient interaction, whether by enlightenment, design or default. This is a systemic trade-off of frightening proportions in troubled times.

A numeraire is needed to justify, regulate and stabilize policies, institutions, practices and interactions among players and actors

Good governance is not context-free. Yet compassion and moral norms, socio-cultural ethos and intergenerational priorities often are not featured with due emphasis in discussions and prescriptions on domestic and global good governance. There are now innumerable markets for money-making within and across nations. However, functioning or competent markets for morality and shared responsibilities, for trust and for cross-cultural tolerance are few and far between. But shared values provide the numeraire needed to justify, regulate and stabilize institutions and policies that are set up and carried out. This applies, in particular, to the collective legitimization and the pluralistic accountability of all those unpalatable trade-offs and transitional dislocations as just, and hence tolerable, for the sake of future opportunities for all. Featuring prominently in such opportunities are four things: enlarged economic space, enhanced social citizenship and mobility, improved political socialization and representation, and a more balanced intergenerational distribution of income and access.

First things first

The "miraculous" success of tiger capitalism has transformed the socio-economic landscape in East and South-East Asia

Most of the (second-generation) tiger economies in East Asia were desperately poor, often resource-scarce and densely populated. It is not an accident of history that they managed to realize in less than three decades a "miraculous" performance in income growth and in social progress, an achievement which had required many more decades and much social sacrifice in the now advanced North. It is also not just a matter of mere international goodwill that a new and distinct nomenclature was invented some two decades ago to refer more accurately to this new breed of high-performing, developing economies in the development literature.

The dramatic and sustained successes of "tiger capitalism" are real; and so is good development governance, (East) Asian style. The policies and processes involved often require enforced and prolonged sacrifices, necessitate much public conformism and steerage by Government, and result in some misdirected allocations of resources. They have also had their share of mid-course corrections or even reversals. Uniquely and remarkably among all other developing areas, however, they had worked well in this part of the world so that decades of technological progress and social advancement were leapfrogged with high economic returns. In fact, a handful of these tiger economies have become major players on the global economic scene after just two decades of dedicated transformation, a distinction shared by very few others in the world.

But there are issues concerning the transformation process

However, issues have also been raised as regards the "quality" of East Asian economic growth. In particular, the adding-up problems seem to be revealed by the (relatively) subdued gains in total factor productivity (the so-called Solow residual); this issue became rather controversial in the region during the (pre-crisis) mid-1990s.[5] The headlong rush for growth has also blindsided a more timely and intensive rethink of, among other basic parameters, the pursuit of creativity and excellence, social capital formation and social protection, and environmental integrity. Indeed, the conditions and circumstances of today are such that individual creativity and individual value-creation, for once, come to the fore in the management of change. However, the new economy itself also emphasizes the great virtues of networks and alliances.

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[5] Notwithstanding a host of methodological and measurement problems, the issue was brought to people's attention by Paul Krugman but it was based largely on a series of research results by Allyn Young. Subsequently, the controversy spawned several studies which have provided a sharper perspective on endogenous (macroeconomic) growth and growth accounting.

The crisis has a silver lining for the region …

There are grounds for cautious optimism, nevertheless. The 1997-1998 crisis has sped up in a large part of the region a series of events and reactions which, on balance, have much improved accountability, participation, transparency and, to a considerable extent, predictability. All these are critical components in the arsenal of human rights and good governance. The crisis has also revitalized efforts in social capital formation, which apparently had not kept pace or been in tune with the changing context of development ushered in by trade and investment globalization, and the new (knowledge-based) economy.[6] Issues in social security are being readdressed as the communal protective foundation is gradually eroded by the current patterns of socio-demographic transition (including townward migration, urbanization, smaller nuclear family size and looser extended family ties, and longer life expectancy). Indeed, such erosion resulted in a less effective response to the socio-economic disruption and dislocation caused by the 1997-1998 crisis.

… and the agenda remains challenging in ensuring equity and rewarding risk-taking

The symphony of change is unfinished. A durable balance has yet to be sustained between the imperative of ensuring a level playing field for all and the need to encourage the creative destruction process and sustain risk-taking behaviour, two pillars of value creation and economic dynamism under market capitalism. As surely, one should not lose faith in, or become impatient with, laissez-faire and competition, all in combination with a little regulatory push and oversight from Government. These market forces, in synergy with competent public sector policies and public institutions, will eventually triumph as a vigilant and unadulterated disciplinarian to rate, to punish and to rein in unproductive corporate cronies and other hangers-on, and counterproductive inter-firm linkages.

The process of change and adaptation has to be nurtured judiciously …

Public and corporate governance under the altered paradigm of world development entails cultural adaptation. But systemic changes and context shifts cannot, and properly should not, be a one-way street. It is well recognized that currently a single model does not yet fit all sizes and shapes; governance institutions are interrelated and path-dependent, being rooted as they are in society and history. Certainly, there will be entrenched resistance as the process of adaptation and evolution constitutes a clear and present threat to fixed mindsets, institutional inertia, (unearned) current privileges, or the failure to adapt and evolve. Without doubt, however, truly people-centred governance, enlightened leadership and cross-cultural accommodation will help to ease the transitional dislocations and collateral damage, thus making

[6] Labour demand, along with the associated rewards, changes structurally as dictated by technological advances and competition. Production was moved from households to mechanized factories with the discovery of steam power. Railways and steamships replaced horse-drawn vehicles and tall ships, accelerated the search for scarce inputs and mass markets and, together with gunpowder, led to the establishment of "new settlements" and colonies for resource supplies and consumption outlets. Meanwhile, electricity greatly facilitated production on an assembly line within factories and culminated in major innovations in industrial organization – notably Taylor's stopwatch sequencing and control of on-the-job motions, and Ford's automated manufacturing on a large and integrated scale. The far-reaching implications of the new economy for labour market transformation are yet to be understood, especially in relation to the emergence of brain (instead of brawn) power and skills more complementary or conducive to the creative and innovative use of intellectual capital, information, networks, and leaner and flatter modes of organization.

the promise of change much larger and more humane than the multisided threat from change itself.

… for there is no substitute for "good governance" and a caring community within the interdependent global villages of our times

The whole issue of governance is far more complex and encompassing than has often been portrayed and perceived in many quarters. The "invisible hand" can be both kind and ruthless, especially if unregulated. Research and applied technology are now increasing in the private domain. Without judicious governance, they are unlikely to be a solution to distribution and social justice problems.[7] Thus Spake Zarathrustra of the long-standing question: Would it be feasible to aim at securing a compact embodying fewer rough edges of untempered market capitalism among interdependent global neighbourhoods and interconnected knowledge societies?[8] There is, indeed, much to be said for a system, style and shade of public and private sector governance whereby various actors and interest groups feel, in everything, duty-bound to do unto all others as they would have all others do unto them. Regrettably, however, such a welcome and needed vision in human interaction and a caring society at large is still wanting at the edge of the new millennium.

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[7] The printing press might have ended the Age of Darkness in Europe in the Middle Ages, ushered in the Age of Reason and Enlightenment and led eventually to political emancipation, the rule of law and democracy. Nevertheless, it failed to ensure universal literacy and suffrage, and distributive justice between the (old) landed class, the capital-owning (newly) rich, the (poorly educated and poorly skilled) peasantry and labour classes, and the populace at large.

[8] Market capitalism and its incentive structures have proved their superior quality, great usefulness and lasting power. This can be seen in the widespread and speedy collapse of the economic and socio-political system of central planning and distribution, plus the triumphant ending of the Cold War in its wake. But the market system itself has its own share of excesses. Some of these blemishes were noted earlier. Other major imperfections can be found in cut-throat competition, beggar-thy-neighbour orientation, self-serving protectionism, wealth accumulation for its own sake, and unbridled commercialism and consumerism.

V PROMOTING SME DEVELOPMENT: SOME ISSUES AND SUGGESTIONS FOR POLICY CONSIDERATION

by Thitapha Wattanapruttipaisan[1]

SMEs are of great socio-economic importance

On several social and economic grounds, small and medium-sized enterprises (SMEs) are of overwhelming importance in most Asian countries, those in the Association of Southeast Asian Nations (ASEAN) included.[2] Typically, the SME sector accounts for upwards of 90 per cent of all firms outside the agricultural sector of East and South-East Asia, and of Japan as well. It is also the biggest source of domestic employment, providing a livelihood for over three quarters of the region's workforce, especially women and the young. The relative share of SMEs in total output and exports is generally much smaller, i.e., one third or less.[3] As such, the SME sector will remain the backbone of virtually every economy in this region and, for that matter, of the world in the foreseeable future.

The 1997-1998 crisis has renewed policy focus on SMEs

A concerted push in support of SME growth and competitiveness, moreover, is no longer an option. In fact, the financial and economic crisis of 1997-1998 has induced a return to "the fundamentals" among the "miracle economies" in East and South-East Asia, including a renewed focus on SMEs. This policy shift has been complemented by higher budget allocations and external aid for the SME sector, including sizeable resources made available by Japan under the so-called New Mizayawa Initiative. Such a reorientation is needed not just to underpin the ongoing socio-economic recovery, which was derailed somewhat again by the 2001-2002 global

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[2] The ASEAN SME Agencies Working Group has been functioning since 1995. The Asia-Pacific Economic Cooperation (APEC) grouping was established in 1989; currently, it has 21 developing and developed economy members. The first APEC SME ministerial meeting was held at Osaka, Japan, in 1994. The APEC Ad Hoc Policy Level Group was first convened at Adelaide, Australia, in the following year and this Group was then converted into a permanent working group in 2000. However, SME issues are also considered by other APEC working groups as they are of a cross-cutting nature, especially in terms of their multisectoral implications and interdependence.

[3] The acute shortage of comparable and up-to-date data on SMEs gives a spotty picture as regards, among many other parameters, their output composition and direct and indirect export production. This chronic shortage is a structural weakness in statistical services common to virtually all developing economies (Hall 2002: 12-17, Regnier 2000: 35-37, and ILO 1977: 36-37). For a more recent and detailed discussion of the important social and economic characteristics of SMEs as well as the impact of 1997-1998 crisis on them, see Alphonso and Co (2001), Regnier (2000), Tambunan (2000), Urata (2000), and van Diermen and others (1997).

economic slowdown. It is also necessary to accommodate an expanding pool of millions of job-seekers (especially young and female workers) and, at the same time, to widen the available opportunities for current as well as potential SME entrepreneurs themselves.

A NEW DEVELOPMENT CONTEXT

Development conditions and circumstances have changed fundamentally

SMEs and, by extension, all business firms have to manage growth and change in an environment where the pace, patterns and organization of production have evolved fundamentally since the late 1980s. Trade liberalization at the global and regional levels and the new information and communications technologies (ICT) have entwined to create rich opportunities as well as formidable challenges to all interdependent countries and enterprises. The following notes on some of the opportunities and challenges most pertinent to SME development serve as a backdrop for the ensuing discussion on related policy issues and suggestions to promote SME growth and competitiveness in the coming decade.

Vast opportunities

There are great opportunities for gainful trade …

A larger proportion of global output is now exported. The ratio of world exports to production was just under one fifth in the late 1990s, compared with only 12 per cent in the early 1980s (ESCAP 2000: 8-9). Even during the global economic slowdown of 2001, the value of world trade (exports) reached US$ 12.7 (US$ 6.2) trillion. Regionally, intra-ASEAN trade has also expanded faster than the group's total trade while the proportion of goods destined for trade within ASEAN is much higher than before the progressive and accelerated tariff reduction arrangements, starting in 1993, under the ASEAN Free Trade Area (AFTA).[4] In addition, most wealth-creating assets such as finance and technologies can now be packaged, located and relocated with relative ease within and across economies and regions.

… for inter-firm linkages to enhance collective capabilities and competitiveness …

Furthermore, there are now greater scope and more opportunities for inter-firm linkages for enhanced collective efficiency, technological and innovation capabilities, and hence competitiveness. In particular, the proliferation of complex networks of international production and cross-border supply chains has widened and deepened the potential and avenues for SME involvement. Furthermore, subcontracting and outsourcing relationships now cover processing and manufacturing activities and services of high value addition and technological sophistication, ranging from original equipment manufacturing, complete-package production, product design and

[4] By comparison, the value for ASEAN trade (exports) was US$ 0.7 (US$ 0.4) trillion during 2001. Annual growth in intra-ASEAN trade averaged almost 12 per cent during 1993-2000; intraregional exports were equivalent to 23 per cent of the total export value in 2000, a much higher proportion than the corresponding figure a decade previously.

engineering, and research and development (R&D) to various other high-end support services.[5]

… and for ICT-based productivity improvements and e-commerce

Another development trend pushed and pulled by the ICT revolution is the significant uplift in productivity, resilience and flexibility of economic activities and services in consequence of the widespread diffusion of ICT.[6] In particular, these new technologies are behind the tremendous upsurge in e-commerce. Currently, this market is largely confined to the developed region, which, for example, accounted for 85 per cent of business-to-business transactions (estimated at some US$ 450 billion) in 2000. E-trade is expected to grow at an exponential rate to reach the trillion-dollar mark well within this decade.[7] Trade via the Internet has now become an intrinsic part of an increasingly large number of SMEs in the developed countries. Respectively about one half and one third of the medium- and small-sized enterprises in Europe maintain an e-mail contact address or a presence on the World Wide Web; there are no comparable data in the case of SMEs in ASEAN or Asia.

Daunting challenges

Formidable challenges to economies and enterprises have also emerged through, for example, more intensified competition …

But the almost unlimited opportunities for gainful growth through trade on the demand side are counterbalanced by formidable challenges on the supply side. First, competition has become increasingly fierce among the global and regional economies and enterprises, SMEs included. There are also many more producers competing for both existing and new markets and market segments for goods, services, finance and other wealth-creating technologies and knowledge. The competitive strength of China was notable in the above regard, even before the country became a member of World Trade Organization in December 2001. Indeed, market penetration and displacing

[5] The process has contributed to a paradigm shift in industrial organization from large-scale vertical integration of hierarchies (of the Fordish and Taylorish varieties) to flatter horizontal production arrangements. These involve the collective participation of smaller enterprises which are, nevertheless, interlinked online and in real time within and across borders. SME participation in the circuit of subcontracting and outsourcing is thus an attractive and feasible bridgehead to durable competitiveness – especially in R&D-intensive sectors, activities and services. See Porter, Sachs and McArthur (2001); Altenburg (2000); Gereffi (1999); and Humphrey (1998). A detailed discussion on the issues, implications and ancillary requirements relating to SMEs as subcontractors on both the supply and demand sides can be found in Wattanapruttipaisan (2002a: 70-84).

[6] Largely as a result, the rate of economic growth in many countries has been boosted higher and their competitive edge has become increasingly sharper. The United States economy, in particular, displayed an astounding performance in the 1990s with an extended period of expansion which became the longest on record in April 2000. Equally striking is that yearly output went up by some 4 per cent during 1997-1999 and by as much as 5 per cent for the first half of 2000. For an examination of some of the major economic benefits of ICT, see APEC (2001: 23-36) and UNCTAD (2001: 25-38).

[7] It should be noted that there are at present very large variations in estimates of the size of e-commerce ranging, for example, from US$ 200 billion to over US$ 600 billion in 2000 alone. Such large discrepancies are due to definitional problems coupled with a critical lack of data and information. See APEC (2001) and UNCTAD (2001) for a comprehensive survey and useful analysis of issues relating respectively to the new economy and e-commerce, the latter with special reference to selected service sectors.

pressures from China have been keenly felt by producers across Asia, particularly those suppliers (including SMEs) at lower stages of technology sophistication and relying on a high import content.[8]

… and more exacting and frequent changes in market standards and demands

Second, consumer preferences and market standards have become more sophisticated and exacting. Competitive advantage is now determined by several non-price parameters such as quality, health and safety, social equity in employment and production, and ecological compatibility of products and processes. Furthermore, market demand is constantly changing, a trend facilitated not least by the rapid advances in ICT, bio-engineering and new materials sciences. In consequence, there are more frequent introductions of new products and processes, faster and more innovative design changes, shorter product cycles and smaller output batches, higher quality and greater mass customization, more just-in-time sourcing and greater punctuality in delivery.

POLICY IMPLICATIONS AND OPTIONS

Competitiveness now depends on, and can be raised by, several factors other than location and natural resource endowments

The new development context requires a change in both perception and practices – in other words, a new or different mindset – in the promotion of SME development. As is apparent from the preceding discussion, competitiveness is increasingly man-made; furthermore, it can be leveraged by factors other than location and natural resource endowments. One lever is through the maintenance of ongoing access to the available store of global information and knowledge, including market standards, marketing opportunities and innovative technologies. Another is embodied in the large gains in collective efficiency and flexibility through participation (whether or not at arm's length) in clusters of firms, or in networks of interlinkages backward with suppliers, laterally with other producers and providers, and forward with users and consumers. Yet another leverage relates to the firm's own capabilities for ongoing learning and improvements in efficiency and flexibility; indeed, business enterprises (both large and small) must become and remain learning organizations under the new development paradigm.

[8] For example, China has managed with notable success to gain a larger share in the G-7 market – namely, Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. Its share in clothing doubled in the 1990s to around 20 per cent, an expansion achieved largely at the expense of exporters from East Asia with the market share of ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) remaining largely stagnant at around 8 per cent. The G-7 market for footwear is now dominated by China, whose relative share was less than 10 per cent in the late 1980s but grew as high as 38 per cent in the late 1990s. Again, this has taken place at the expense of both the East Asian suppliers and ASEAN-4. Similar trends in market penetration by China can also be observed in sectors such as telecommunications equipment, office and automatic data processing machinery and electrical appliances. Meanwhile, China has been and will remain the dominant supplier of textiles and clothing to Japan, with a relative share rising from 44 to 62 per cent between 1993 and 1999. For further details, see OECD (2002: 138-142). Wattanapruttipaisan (2002b) discusses at some length the gains, issues and implications associated with the proposed ASEAN-China Free Trade Area; this proposal was made at the summit of leaders in Singapore in November 2000.

Competitive SMEs can transform regions and economies

A note of cautious optimism is warranted at this juncture. There is much evidence on the emergence of competitive industries and on the revitalization of domestic regions pushed and driven largely by networks and clusters of SMEs. The process has taken place in both developed countries, notably Western Europe in the late 1980s, and developing economies.[9] Within Asia itself, many large domestic firms as well as transnational business conglomerates, commanding widespread "brand" or "name" recognition, are born and bred locally. However, the very large majority of them had a more humble origin mostly as small-scale enterprises, often operating in smaller townships, at the initial stages of their start-up around half a decade or so ago.[10]

Monitoring and benchmarking competitiveness

Resource constraints emphasize the need for policy focus and targeting …

In general, SMEs will have to be assisted and facilitated to grow, multiply and replicate into a sufficient (critical) mass across industries and sectors. In the process, the level of competitiveness and dynamism of domestic enterprises and, by implication, of the economy as a whole will be greatly enhanced.[11] However, focus and targeting are unavoidable in the context of SME support activities and services. On the one hand, Government has become "leaner and meaner" with functional divestment through policy liberalization, asset privatization and administrative deregulation. In fact, no countries will have the necessary resources for the concurrent and open-ended support of the massive number of their SMEs; these range from several hundred thousands to a few millions in the larger, more populous and/or SME-intensive economies (e.g., China, Indonesia, the Republic of Korea, and Taiwan Province of China).

[9] See, for example, Liedholm and Mead (1998); UNCTAD and GATE (1993); and Senenberger, Loveman and Piore (1990) plus the extensive bibliographies cited in those publications.

[10] Yoshihara (1988: 153-263) provides an interesting and extensive account of the stellar rise of many of the present conglomerates which were formerly small and family-controlled enterprises in South-East Asia. In a related context, two of the world's most famous corporations, Sony and Honda, started out as small manufacturing companies in small-town Japan.

[11] Efficient firms, for example, make it possible for other enterprises to purchase inputs more cheaply. Dynamic and innovative firms induce others to keep up with the latest technologies in production, management and organization. Flexible enterprises speed up the capabilities to respond quickly in other firms which have forward or backward linkages to them. Indeed, the recent attention to national competitiveness and competitiveness studies reflects a growing appreciation that competitive advantage is systemic in nature. There is a large amount of literature on the concept, and policy implications, of "systemic competitiveness". See, for example, Porter, Sachs and McArthur (2001: 17-23); Esser and others (1999: 62-85); and Altenburg, Hillebrand and Meyer-Stamer (1998); and the references cited by them.

… and for an efficiency-oriented, time-bound approach in support and facilitation of SMEs

On the other hand, there are huge differences in the capabilities and competitiveness of SMEs. As is the case of sectors and industries regarded by Government as of priority importance,[12] business enterprises deserve closer attention and concerted support if they are more efficient, innovative, growth-oriented, outward looking, learning-capable and linkage-ready. First, such firms are likely to be very much fewer in number. Policy intervention would have a better chance of success as it would be more focused and manageable, both administratively and financially. Second, they will be more receptive to an efficiency-oriented and time-bound approach in policy support and facilitation. This approach is similar to the provision of fishing rods and related fishing skills to SMEs; it is thus different from the distribution of the fish itself to the target beneficiaries as has often been the case.[13] Third, they are also better placed for self-diagnosis and self-improvement after the initial provision of assistance and facilitation. Meanwhile, partial cost recovery in cash and in kind, plus resource pooling, are comparatively more feasible among these target firms.

Thus, the current and evolving capabilities and competitiveness of selective segments of the SME sector have to be measured, monitored and benchmarked in an objective and systematic manner

Competitiveness has a foundation at the microlevel, whether or not it is measured and benchmarked at the industry, sectoral or national level (Porter, Sachs and McArthur 2001: 21). Regrettably, however, there is currently little, if any, data and information needed for more focused and effective monitoring and comparison of the evolving capabilities and potential of the top layers of SMEs in priority sectors and industries over time. Such an exercise is indispensable for an accurate identification of the core competencies of the SMEs under consideration as well as of their shared areas of weakness for follow-up capacity-building. Indeed, learning what a country and its enterprises are, or can be, good at producing is a key challenge of economic development (Rodrik 2002: 7a). But the same exercise is also essential for better SME performance management and policy impact assessment. In particular, useful benchmarks can be obtained as to the ongoing changes (whether progressive or regressive) in the capabilities and competitiveness of direct SME exporters and first-rank SME suppliers to large domestic enterprises or cross-border production networks. These benchmarks constitute a solid input for the consideration of policy framers as well as for emulation by those SMEs currently in the lower ranks or tiers of suppliers.

To be credible, the data and information for monitoring and benchmarking purposes have to be obtained in an objective, systematic, periodic and

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[12] Generally, these priority sectors and industries are likely to exhibit high levels of employment, value added and/or technological sophistication; extensive inter-firm linkages (backward, lateral and forward within and/or across borders); a heavy export orientation; and prospective economies of scale and scope. Typically among those with a large SME presence are a wide range of agro-processing activities (e.g., food, wood and fisheries), manufactures (certain automotive and electronics parts and components, textiles and garments, and some capital goods), pharmaceutical products, information technologies, construction, and hotel and tourism services.

[13] A welfare-based policy approach in support of the SME sector has its own deserved place within the overall policy and institutional framework. It is necessary to safeguard social equity and act as a social safety net in times of crisis or transitional adjustment. But this has to be explicitly stated in terms of objectives and expected outcomes for the needed transparency and accountability, as well as for accurate and measurable performance evaluation.

(statistically) robust manner. The persisting shortage of sample survey results in this regard is another structural statistical weakness in most developing countries, despite the intrinsic socio-economic importance of SMEs and the renewed policy focus on them. In this connection, a framework for such a remedial exercise is discussed at length, and a pilot project for testing purposes proposed, in Wattanapruttipaisan (2002a: 70-78 and 84-85).[14]

Subcontracting compact

Sustainable arrangements in subcontracting and outsourcing depend on sustained compliance with exacting requirements by the SMEs involved

As noted previously, inter-firm networking is a ready bridgehead to domestic and external competitiveness, and the promotion of it has been given high policy priority in the developing world, including ASEAN. The sustainability of such inter-firm arrangements is naturally conditional on durable compliance with exacting requirements for outsourcing and subcontracting (Altenburg 2000, Gereffi 1999 and Humphrey 1998). However, a major drawback in business-matching events and trade fairs is the lack of solid information regarding the evolving capabilities of the producers concerned. A product or service may appear competitive on display but there is no guarantee that the needed volume or variety of supplies can be produced by the pertinent enterprises cost-effectively, and with their quality and reliability remaining uniform or assured. In addition, sustained competitiveness depends on learning-based and innovation-driven improvements in product design, quality and delivery. For a variety of reasons, however, the incremental improvements may not be realized in an efficient, continuous and flexible manner by the suppliers concerned.

The compliance process requires changes in both perceptions and business practices by many SMEs

Indeed, the compliance process itself requires mindset changes because a large number of subcontracting prerequisites are traditionally not practised or expected by most SMEs, among other firms. To begin with, there is little room for compromise with quality, and compliance with quality management systems recognized worldwide is through certification under the International Organization for Standardization (ISO) 9000 series of standards, ISO 9001 and 9002 especially.[15] Such certification is no longer an option. But changes

[14] Briefly speaking, SME capabilities and competitiveness are conceptually grouped under seven categories, each with its own set of parameters and guidelines. The overall environment in which SMEs operate is categorized as “Nature and readiness of firms”. “Entrepreneurial characteristics” are the driving force of enterprises, whether they are large businesses or SMEs. The two categories dealing with “Capabilities” and “Competitiveness” are indicative, by and large, of the initial conditions and circumstances of the SMEs concerned. Matters included in “Production organization” serve as a proxy for the potential for productivity upgrading and competitive growth by the SMEs under consideration, a process which is innovation-led, learning-based and investment-driven. In a way, this category mirrors the (new) Growth Competitiveness Index, which was (recently) introduced in 2000 by the World Economic Forum (WEF). Meanwhile, the groupings on “Capabilities” and “Competitiveness” are an approximation of the WEF Current Competitiveness Index. The last two categories are “Finance” and “Human resource development”.

[15] The two are identical except for the exclusion of the design element from ISO 9002. ISO 9001, for example, covers 20 separate system elements pertaining to design, development, production, installation and servicing. Moreover, certain system elements relating to environmental safety and control have recently been incorporated as part of the revised version of ISO 9001. This is because the ISO 14000 series of standards are not directly concerned with manufacturing processes.

are also required in several other business practices, which include certain conditions as to employment and workers' amenities in the workplace, regular audits of factory layouts and work flows, the offer of unconditional product warranties and after-sales service, and the extension of credit on delivered products. There is, moreover, the imposition of penalties for under-performance, for example, in terms of quality consistency, defect and rework ratios and liabilities, and timeliness in delivery (Altenburg 2000: 32-34).

A subcontracting compact or subcontracting code of conduct for SMEs?

All these require, in turn, a compilation of the typical preconditions for inter-firm networking, including through subcontracting. The listed specifications can be regarded as general guidelines or "best practices" for emulation expected of SMEs from the demand side. Likewise, from a supply-side perspective, they can form the basis of an SME subcontracting compact or "code of conduct". Demonstrated adherence to such a compact or code would qualify the SMEs concerned as ready for participation in subcontracting or outsourcing arrangements, just as ISO certification does for quality control, assurance and management.

ICT and e-commerce

Parallel efforts at demand-side market creation and supply-side capacity-building are required for the more effective and widespread diffusion and adoption of ICT and e-business, including within the SME sector

The issue in this context is not whether to assist SMEs in investing in ICT-based facilities and services. Rather, it is how best to encourage SMEs to make the most cost-effective use of the new technologies in production, marketing and networking. A word of caution is necessary, however. First, the tremendous expansion in digital connectivity and e-commerce has been highly concentrated in North America and Western Europe, as pointed out earlier. Second, many regional SMEs, those on the top layers in priority industries and sectors especially, will surely have "to go with the flow" of electronic interactivity (or be crushed by it). As surely, however, there is an extensive agenda to be accomplished before large segments of the SME sector can be transformed into the so-called "virtual" enterprises and entrepreneurs.

Within the middle- and low-income countries in Asia, for example, the constraints on e-commerce among SMEs are wide-ranging.[16] Significant efforts have to be made by both the public and private sectors to create,

[16] There is the Catch-22 issue of low and limited usage of e-business by both customers and suppliers at present. This reflects, in part, a lack of trust and confidence, which itself is due to an inadequate supply of soft infrastructure (as regards, for example, the security of transactions; appropriate support, payment and distribution systems; e-contract enforcement; and other legal and liability issues both within and across borders). There are also limited knowledge, awareness and skills on the part of SMEs concerning the promise and requirements of ICT as well as e-business. Moreover, significant barriers exist in the form of insufficient access of SMEs to ICT infrastructure, hardware and software of suitable quality and at an affordable cost in time and money. PricewaterhouseCoopers (1999) contains a useful survey of the main issues and options relating to e-commerce and SMEs in the APEC region. Debroy (2001: 37-43) provides a sober view on "www" in the Indian context, namely, where will the ICT diffusion happen (urban and/or rural areas?); who will facilitate it (private initiatives or government?); and lastly, there is the why for the education system itself. A detailed consideration of e-commerce in the context of low-income countries and economies in transition, specifically China, can be found in UNCTAD (2001: 189-250).

regulate, stabilize and legitimize the domestic markets for both ICT and e-business. This process is wide-ranging in its intersectoral implications, involving property right protection and contract enforcement, awareness-raising and information dissemination, the provision of time-bound incentives and other assistance, etc. At the same time, parallel measures will have to be carried out to build up the ICT and e-commerce capabilities and potential of the targeted SMEs, thus enhancing productivity and competitiveness on the supply side. An overarching issue in connection with market creation and capacity-building is the quality, relevance and accessibility of domestic institutions for education, training and extension services to underpin more effective diffusion and adaptation of ICT economy-wide over time.

Policy consistency

There is scope for greater consistency and better coordination of policies and regulations …

An enabling policy and institutional environment matters even more in another context. Because of their limited scale of operations, the costs of participation and capacity-building are relatively more disproportionate for SMEs, compared with those shouldered by large firms. At the same time, by default or by accident, changes and adjustments in the policy, regulatory and institutional framework have not always empowered SMEs. The sector and its entrepreneurs are often constrained by opaque discretion, overbearing regulations, expensive delays and, above all, the well-known "perverse incentive syndrome".[17] Remedial efforts have been made by countries to promote SMEs, including through the provision of both inducements and prerequisites for large-scale and transnational enterprises to foster backwards and forwards linkages with smaller-scale suppliers. But again, this "carrot-and-stick" approach remains feasible and sustainable only with the continuous availability of SME inputs which comply with the exacting requirements of subcontracting and outsourcing.

… and a one-stop institution in support of SME sector growth, transformation and integration

A one-stop agency for the promotion of SME development would prove helpful, just like its counterpart in the promotion of foreign direct investment. There has been some centralization of responsibilities in a number of countries, including Malaysia and Thailand, where the main concern is to ensure better coordination and greater coherence and consistency of policies and regulations impinging on SMEs. However, other important functions include advocacy, outreach (especially in capacity-building and information dissemination) and policy performance and impact evaluation. Again, an effective discharge of these functions would depend significantly on the systematic and sustained collection of data and information for the monitoring and benchmarking of SME capabilities, competitiveness and adherence to certain subcontracting compacts or codes of conduct, as discussed earlier.

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[17] This originates from the minimum requirements in production scale, local content, capital investment and/or export levels as a precondition for government incentives and assistance. There are valid economic, financial and technological reasons for granting benefits and privileges in exchange for certain minimum or baseline conditions or stipulations (e.g., prospective economies of scale and scope, greater employment volume and market penetration, easier transfer and dissemination of new technologies, and better intellectual property and environmental protection).

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VI EMPOWERING WOMEN THROUGH SELF-HELP MICROCREDIT PROGRAMMES[1]

Introduction

Self-help programmes combined with microcredit can transform women's lives

A significant development in recent years has been the mushrooming of community-based organizations and initiatives at the local level for women. Reports indicate that self-help programmes, often in the form of savings and credit or microcredit schemes, have succeeded in changing the lives of poor women, enhancing incomes and generating positive externalities such as increased self-esteem.[2] However, in recent years, counter-arguments have also been advanced, suggesting that there could be negative effects or that the results have not been as encouraging as previously reported. This paper addresses the challenging issue of whether self-help microcredit programmes are tools for empowering poor women. The observations made and conclusions drawn are based mainly on field missions undertaken by the author while reviewing gender-mainstreaming projects in Asia funded by the International Fund for Agricultural Development (IFAD), field visits to community development projects and documented studies (Krishnaraj and Kay 2002).

What is empowerment?

Empowerment is a process by which women take control of their lives through expansion of their choices

The concept of empowerment has been the subject of much intellectual discourse and analysis. For the purposes of this discussion, the conceptual framework expounded by United Nations is a useful starting point (United Nations 2001). Empowerment is defined as the processes by which women take control and ownership of their lives through expansion of their choices. Thus, it is the process of acquiring the ability to make strategic life choices in a context where this ability has previously been denied. The core elements of empowerment have been defined as agency (the ability to define one's goals and act upon them), awareness of gendered power structures, self-esteem and self-confidence (Kabeer 2001). Empowerment can take place at a hierarchy of different levels – individual, household, community and societal – and is facilitated by providing encouraging factors (e.g., exposure to new activities, which can build capacities) and removing inhibiting factors (e.g., lack of resources and skills).

[1] Prepared by Thelma Kay, Chief, Gender and Development Section, Emerging Social Issues Division, ESCAP.

[2] In this paper, the term "self-help group" is used to cover any small group of women at the community level organized as a collective unit.

Social mobilization and economic security are vital to empowerment

Two vital processes have been identified as important for empowerment. The first is social mobilization and collective agency, as poor women often lack the basic capabilities and self-confidence to counter and challenge existing disparities and barriers against them. Often, change agents are needed to catalyse social mobilization consciously. Second, the process of social mobilization needs to be accompanied and complemented by economic security. As long as the disadvantaged suffer from economic deprivation and livelihood insecurity, they will not be in a position to mobilize (UNDP 2001).

With the above brief conceptual understanding of empowerment, what strategies can be used effectively to empower women? In many developing countries (especially in South Asia), one strategy which has been found to be promising is participatory institution building in the self-help groups, often coupled with savings and microcredit loans. A closer look at the impact of these schemes on the empowerment of women reveals a mixed picture, with positive aspects and some limitations.

Empowering aspects of self-help microcredit schemes

Microcredit programmes have played a valuable role in reducing vulnerability

Self-help groups intermediated by microcredit have been shown to have positive effects on women, with some of these impacts being ripple effects. They have played valuable roles in reducing the vulnerability of the poor, through asset creation, income and consumption smoothing, provision of emergency assistance, and empowering and emboldening women by giving them control over assets and increased self-esteem and knowledge (Zaman 2001). Several recent assessment studies have also generally reported positive impacts (Simanowitz and Walker 2002).

Asset creation and income increase are the most significant results of microcredit schemes

Impact assessment studies point to asset creation as one of the main indicators, measurable by empirical data. From field visits done by the author, and from various documented sources, it would appear that financial services, especially microcredit, provided to self-help groups have brought about an increase in household income. For example, the 2000 United Nations Common Country Assessment for Bangladesh felt that microcredit had lessened the severity of poverty and helped to increase total income per household by 29 per cent. A World Bank study found that a 10 per cent increase in borrowing had led to an increase in women's non-land assets by 2 per cent for loans from the Grameen Bank and 1.2 per cent for loans from the Bangladesh Rural Advancement Committee (BRAC) (World Bank 1998). In India, microcredit studies done on groups dealing with dairy farming have noted positive profit levels and short payback periods for loans (Lalitha and Nagarajan 2002).[3] Earnings generated from such undertakings have been instrumental in increasing the physical well-being of the household, often through better nutrition and sanitation. The household's asset base

[3] Also reported to the author in a field visit to Mewat, India, where dairy self-help groups have been operating.

has also been enhanced by the addition of jewellery (a portable asset), improved housing and land purchase in some cases.

Microcredit can also help in meeting short-term liquidity needs and consumption smoothing

Studies in several countries point out that loans are sometimes used for consumption smoothing, not production. It has been pointed out that the poor often have short-term liquidity needs (frequently requiring lump-sum payments), which would normally be met by usurious moneylenders if other financial sources such as microcredit were not available. Sudden and debilitating shocks can force poor households into disempowering situations of distress. During the Asian economic crisis, self-help microcredit groups served as important cushions and safety nets. A high proportion of the funds made available for self-help microcredit schemes were utilized by women, enabling them to meet the subsistence needs of their families during those difficult economic times (ESCAP 2002). Many self-help programmes have also incorporated elements of savings, which can be used for purposes such as health insurance and emergency loans, thereby serving as private safety nets.

Changing gender relations within the household are intrinsic to greater empowerment

Another set of indicators, which are more intrinsic, revolves around changing gender relations within the household. In the field studies undertaken for the IFAD gender mainstreaming review, women who generated increased income through self-help schemes reported that they had gained greater respect within the household, often with perceptible attitudinal change. Men have been reported to offer little resistance towards the enhanced economic activity of women because such activities were seen as contributing to household well-being. Men and older children have also been reported to be helping with household duties and with the income-generating activity. In Bangladesh, women showed a good deal of empowerment in their capacity to articulate their needs and in their receptivity to new ideas. More impressive was the emergence of women's groups as a dynamic, articulate constituency (Krishnaraj and Kay 2002). These first-hand observations and in-depth interviews appear to validate the findings of other studies (Cheston and Kuhn 2002).

Women's decision-making power has been enhanced by their greater economic status

One important indicator of empowerment is the ability to make decisions within the household. On this issue, in the field studies conducted under the IFAD gender mainstreaming review, many women interviewed indicated that they could decide on spending their own income, although men were often consulted. In some countries, where mobility outside the home is often restricted, women have reported increased mobility, simply having to inform male heads of households instead of soliciting their permission.

In the realm of self-confidence and self-esteem, the feedback from the IFAD gender mainstreaming review has been very positive. Reports indicate that women are more able to articulate their views and were able to command attention and respect within the household, and often within the community. Increased self-confidence was especially pronounced when women had been exposed to training on women's rights and social and political issues.

Not a panacea

Microcredit schemes have not been able to lift women out of abject poverty as they cannot transform social relations and the structural causes of poverty

Self-help groups, especially linked to microcredit schemes, have not been without their critics, nor are they are a panacea for meeting challenges in economic and social development. It is widely recognized that such schemes are not universally successful. For example, some studies have shown that microcredit will not work in locations that do not have sufficient cash-based market activity, are isolated and with low population densities, or are largely self-contained with few outside ties, such as in some Pacific island countries (UNDP 1997). Some critics have pointed out that while microcredit schemes can reduce vulnerability, they have not lifted women out of abject poverty or have taken a long time to demonstrate any significant impact. On their own, microcredit schemes have limitations as they cannot transform social relations and the structural causes of poverty.

What role can these schemes play in social transformation?

Thus, a broader issue remains: What role, if any, can these schemes have in transforming society? In many societies, discrimination against women and gender inequality is the result of structural impediments and problems built into the social order, often reinforced by culture and tradition. To bring about social transformation, two important dimensions have to be considered: access, ownership and control of productive resources; and inclusion in the decision-making process.

Access, ownership and control of productive resources

Exclusion of poor women from land rights has been highlighted as contributory to their marginalization. Some self-help groups have reportedly been able to purchase or lease land or user rights to community forests (Nepal) and fishing ponds (Bangladesh) collectively, thereby laying the foundation for enhanced food security and agricultural productivity. The Grameen Bank in Bangladesh provides housing loans to members with a track record of three loan cycles and with title deeds to the land on which the house is built. As most Grameen members are women, one of the results is that women have had title deeds transferred to them, often from their husbands, to obtain these loans. This has also reduced the incidence of divorce since women as owners of their own homes cannot be easily evicted (Yunus 1998).

Moving the products of women's self-help groups up the value-added scale is vital to sustaining progress

One promising strategy is the use of market-driven measures to enable the poor to own and operate enterprises to add value to the primary products they usually produce. An interesting example is the Anand Milk Union Limited (commonly known as Amul) in India, a dairy cooperative of village women who own cows and produce milk and milk-based products on a profit-sharing basis. Another is Grameen Telecoms, which is seeking a listing on the stock exchange and is planning to allocate shares to members such as the telephone ladies running the company in the villages. Another strategy is to use the savings of self-help groups to invest in equities. A federation of self-help groups, such as the Self-Employed Women's Association in India, can also move towards becoming a non-bank financial intermediary, lending to both members and non-members.

Inclusion in decision-making

Women's participation in decision-making outside the self-help group is still limited

Men tend to dominate political and community decisions, whether communities are matrilineal or patrilineal. Even where participatory and inclusive methods of community development are used, women are often not well represented because village heads select participants based on ascribed leadership positions, such as household head, and perceived leadership capacity. Women can also be excluded because of their preoccupation with household duties. It has been observed that even when women become members of committees, men still tend to dominate in the work.

As women are an important part of the community, building their capabilities to manage communities and community projects should be enhanced. One measure which has been taken with some success is to assign specific responsibilities to women's groups in the community. For example, in IFAD's Andhra Pradesh Tribal Development Project and North-Eastern Region Community Resource Management Project in India, women's self-help groups have been assigned specific responsibilities for managing natural resources after their proven track record in successfully managing the activities of their own groups. There have been reports of women's self-help groups serving a social audit function and, in one instance, exposing corruption in the supply of pipes and ordering replacements.[4]

Women from self-help groups have also been elected to public office, their participation in such groups serving as an incubator for community leadership. However, these instances are still incipient and not widespread and self-help groups remain largely isolated islands of activity.

Pathways to empowerment

Self-help groups have been instrumental in empowerment by enabling women to work together in collective agency. Women's networks do not usually obtain business or political favours as they command few economic resources and frequently rely on time and non-monetized labour exchange. However, self-help groups, when combined with savings and credit, have enabled women to benefit economically by monetizing their contributions and in the process have empowered them to become agents of change.

Women learn to work for a common purpose in self-help groups leading to the formation of social capital but these groups are often narrowly focused on microcredit

A related aspect is that self-help groups have facilitated the formation of social capital, where people learn to work together for a common purpose in a group or organization (Putnam 2000). The ability to associate depends on the degree to which communities share norms and values and are able to subordinate individual interests to those of larger groups. Out of these shared values comes trust, with the potential for social, economic and political change. However, these groups are often narrowly focused on microcredit, which, although useful as an entry point, can also limit and confine these groups to very small-scale activities with limited impact beyond the immediate family.

[4] Interview with IFAD project staff, Shillong, Meghalaya, India.

Social mobilization requires broader conceptualization and may need the harnessing of the collective strength of self-help groups in a federation

Instead, this process of social mobilization should be conceptualized more broadly so that the groups can perform more encompassing roles. Institutional frameworks, which bring these groups together and harness their collective strengths, are also necessary. A promising example is the federating of self-help groups, where all such groups in one village form an apex body consisting of selected representatives of each group. Women leaders in federated bodies have gained prestige and recognition, which has paved their path to elected office in local government. These federated bodies can be linked further, reaching up to the national level, presenting opportunities for women to engage in decision-making at higher levels. It is at the level of political decision-making that women can hope to have a voice in transforming society. In this regard, affirmative action, whereby women are allocated quotas in various decision-making bodies, can be an effective strategy. Examples are the reserved seats for women in the local tambon administrative organizations in Thailand and in the parliaments of Pakistan and Bangladesh.

Gender relations

The instrumental role of women in obtaining loans adds to their status even though loan proceeds enter the household income pool

The perception that microcredit is an empowering tool for women has in recent years come under close and in some instances negative scrutiny. Critics have charged that microcredit accessed by women has often been appropriated or "hijacked" by other household members, leaving women burdened with the responsibility of repayment and the sanctions of default (Goetz and Sen Gupta 1996). However, it can be argued that communities in many developing countries are collectivities with credit entering the overall household income pool and loans entered into for the good of the household even when the loan is in the woman's name. It has also been contended that even if other members of the household use the funds, the instrumental role of the woman in having preferential access to and obtaining the loan strengthens her bargaining position within the household.

Collective agency may be the best protection for women combating oppression

It has been reported that the formation of self-help groups and the involvement of women in income-generating activities has brought about increased violence against women in the household. While this may be true in some cases, there are also reports that violence has diminished as men come to realize and appreciate the importance and value of the economic contributions to the household. Two aspects pertaining to gender relations are worthy of note. The first could be postulated as increased respect for women, as pointed out earlier. The second is the utilization of the self-help groups as coalitions to protect, and seek redress for, women subjected to gender-based violence. In communities where women are subordinated and traditionally subjugated, the effectiveness of building collective agency to counter oppression should not be underestimated.

However, these challenges to the assumed and to a large extent accepted positive role of microcredit for women merit further review. Underestimation of the importance and impact of such criticism could threaten the viability and credibility of microcredit among its current community of supporters.

Reconciling pro-poor policy with sustainability

The very poor risk exclusion from self-help microcredit groups unless specific measures are taken to ensure their participation

While microcredit schemes have reduced the vulnerability of women, it has often been pointed out that these schemes do not reduce poverty. One important shortcoming is that as microcredit is made available to groups, based on collective collateral, the process of group formation often precludes the very poor, who are perceived as being poor credit risks (Krishnaraj and Kay 2002 and FAO 2002). The self-selection process will therefore be based on "positive assortative matching", where group members exercise risk aversion by excluding those who may not be able to fulfil repayment requirements, leading to the economic rationing of credit. As self-help microcredit schemes are often lauded as one of the most effective mechanisms to reach the poor, measures must be taken to ensure that the poor are not excluded. These measures could include more careful targeting to include the poor and vulnerable[5] and incentives to mix groups to ensure that the poor are not excluded.[6] Literacy and numeracy training, where the need for such training exists, has proven to be essential for the very poor to benefit from microcredit schemes. Similarly, training in legal literacy, rights and gender awareness are important complements to microcredit for the empowerment of women.

To make the transition out of poverty, auxiliary services will be needed in addition to microcredit

Auxiliary services that have reportedly been effective in enhancing and complementing microcredit are business development services, business planning, marketing, accounting and technology. These services take on increasing importance as funds for microcredit become more easily available and the issue of utilization becomes important. For example, cases abound of villages producing the same products, resulting in problems of marketing. The proliferation of funds in some countries has also led to market saturation, with borrowers taking out multiple loans, refinancing loans and even defaulting on loans as the associated sanction of being unable to take out a fresh loan loses its effect because of the availability of loans from other sources.

Complementary non-financial services can enable microcredit to play a greater role in reducing poverty and vulnerability

Microcredit practitioners have often maintained that their first and highest priority is financial sustainability. Non-financial services were seen as adding costs and detracting from the main aims of microcredit. However, experience from several countries has shown that microcredit can play a greater role in poverty and vulnerability reduction when it is complemented by non-financial services. Among the ancillary services, one of the most useful would be health-related. These "microcredit plus" schemes can take the form of microinsurance, especially for health care, which would be most useful for mitigating risks in poor households that can be devastated by illness. In some countries, attempts to link microcredit with HIV/AIDS programmes

[5] Measures for targeting the poor have been devised by organizations such as the Consultative Group to Assist the Poorest, the Foundation for International Community Assistance and Credit and Savings for the Hardcore Poor.

[6] For example, the Luliang Prefecture Women's Federation in Shanxi Province, China, provides subsidized loans on the condition that the borrower provide training and supervision to two very poor neighbours.

have met with a certain amount of success (UNDP 1999). The pension fund of the recently revamped operations of the Grameen Bank (Grameen Bank II) is reportedly popular with borrowers (Yunus 2002). The challenge is to maintain financial viability while providing complementary non-financial services to meet poverty reduction and development goals. This requires pro-poor policies and poverty-focused schemes.

The success of microcredit schemes needs to be measured more broadly

The yardstick for measuring the performance of these schemes should not be based on economic variables, such as loan repayment rates, alone. While financial viability is important for sustainability, indicators should also include the contribution to meeting basic needs for household subsistence, reducing vulnerability to risks and enhancing social capital and empowering women.

Conclusion

A case study of a self-help group from Narathiwat, Thailand

This paper will conclude with a case study from Narathiwat, a predominantly Muslim province in southern Thailand, which provides some useful insights into the potential of community-based self-help groups run by women.[7] The Department of Skills Development of the Ministry of Labour and Social Welfare has reported that following attendance at skills development courses run by the Department, several self-help groups were formed to manufacture products such as batik and embroidered articles. Start-up funding for equipment and materials was also made available. These groups have made good progress and now have markets for their products in tourist resorts and in Malaysia. The Internet has also been successfully used for commercial transactions.

Several government departments provided coordinated support

With the success of the groups, further technical assistance has been provided through other government departments such as the Department of Industrial Promotion (for basic business skills training and trade promotion activities such as exhibitions) and the Ministry of Health (for occupational health such as proper lighting). The Department of Skills Development is arranging for courses to improve members' skills further to increase value addition for the groups' products. The coordinated role of different government departments in nurturing (but not directing) the entreprenuerial ability of these groups is noteworthy.

The project has fostered participation by all members of the family

At the household level, family members have been mobilized to help in packaging and transport, and the younger members (including young men) help in designing goods. The status of these women within their households is reported to have been enhanced. At the community level, some members of the women's groups are reportedly engaged in local community management structures and issues. With the decentralization of development funds, such as the Village Fund scheme, women from these groups, having demonstrated their ability to engage in business activities, are able to find their place in fund

[7] Based on the report of a mission to Narathiwat, Thailand, by Lim Teck Ghee, Regional Adviser on Poverty Alleviation and Social Integration, ESCAP, in August 2002.

management positions. Village elders, traditionally men, are reported to have welcomed the participation and involvement of these women.[8]

With suitable support, self-help groups can move on to collective action at the community level but more remains to be done for sustained poverty alleviation

This example demonstrates the multiple aspects of self-help groups developing in a phased process, starting with economic enhancement, leading to empowerment at the individual level, and then moving on to collective action at the community level. It also shows that various government bodies can play supportive roles. However, these initiatives will not be able to bring about social transformation in the aggregate unless issues of control and ownership of the production process, linkages with a broader market and greater decision-making at the political level are tackled. Initiatives at the community level can be a useful tool to empower women, forging gender equality from the grass-roots to the national level. However, these initiatives have to incorporate strategies and measures that empower the poor, especially poor women, and enable them to participate in the development and transformation of society if poverty is to be truly alleviated.

[8] Interview with officials of the Department of Skills Development, Ministry of Labour and Social Welfare, Thailand.

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VII COMPETITION POLICY IN DEVELOPING COUNTRIES: AN ASIA-PACIFIC PERSPECTIVE

by Pradeep S. Mehta[1]

Introduction

The diversity of the Asian and Pacific region cannot be ignored in discussions on competition policy

No other region in the world has so much diversity as the Asia-Pacific region. It is home to a few of the most developed countries in the world, like Japan and Australia, but it also houses many least developed countries, like the Lao People's Democratic Republic and Nepal. The newly industrialized countries as well as some of the rich oil-exporting countries are also part of this region. Yet out of the 1.2 billion poor people of the world who live on less than a dollar a day, about 800 million live in this region alone. When we talk about competition policy in the region or, for that matter, any other policy, this diversity cannot be ignored. Further, no policy response can be designed without looking at its effects on the 800 million poor. Competition policy is no exception.

The World Trade Organization (WTO) organized a Regional Workshop on Competition Policy, Economic Development and the Multilateral Trading System in 2000 at Phuket, Thailand, which was attended by representatives of a large number of Asian developing countries. The purpose of the Workshop was to examine progress in the enactment and enforcement of a competition regime in the countries of the region, including regional and international dimensions. At this meeting, the most important question raised was how a competitive environment could serve to enhance rather than impair economic development. There was a good degree of agreement that industrial policy, if it was to be useful, had to be combined with competition policy even if the mix between the two policies needed to vary with the level of economic development.

Competition policy aims to increase the efficiency and dynamism of the economy

The main objective of competition policy and law is to preserve and promote competition as a means of ensuring the efficient allocation of resources in an economy. This should result in lower prices and adequate supplies for consumers and, it is hoped, faster growth and a more equitable distribution of income. By lowering barriers to the entry of new firms into an industry, competition policy helps to create an enabling environment for entrepreneurial development, an essential prerequisite for a vibrant economy (OECD and Khemani 1998).

[1] Consumer Unity and Trust Society (CUTS) Centre for International Trade, Economics and Environment, Jaipur, India. Research assistance provided by Nitya Nanda of CUTS.

Competition policy also promotes good governance in the corporate sector as well as in government by diminishing the opportunities for rent-seeking behaviour and the corruption that often accompanies it. Competition law and regulatory tools are invoked mainly to take care of firm behaviour and market failures. Governments often intervene when markets fail but in the absence of a clearly defined competition policy and regulatory mechanisms, the intervention can be arbitrary and serve vested interests rather than the poor.

Increased liberalization and deregulation make the need for competition policy urgent

At present, several developing countries in the region are going through a phase of privatization and deregulation. Many State-owned enterprises affected by these policies currently enjoy monopoly power in the market. In such a situation the absence of a competition policy and an adequate regulatory mechanism will simply mean the transfer of monopoly power from the public to the private sector. This is likely to harm the interests of consumers, especially the poor.

International anti-competitive practices can also be harmful to small and developing countries without effective competition laws. The available evidence suggests that international cartels of private firms that engage in restrictive practices designed to limit competition in international trade do exist. These arrangements can be quite durable and detrimental to economic development (Levenstein and Suslow 2001). Cross-border mergers and acquisitions that lead to market dominance and the restrictive practices that some transnational corporations engage in further necessitate competition legislation. Discussions have been taking place under WTO auspices on the interaction between trade and competition policy, an area of great interest to the highly trade-dependent economies of the Asian and Pacific region.

This paper examines the contours of a competition law, with a brief consideration of regulatory policies. It concludes with a discussion on how a healthy and dynamic competition culture can be fostered in the countries of the region.

Nature of competition law

Some of the developing countries in the region enacted a competition law many years ago …

Of the countries in the region, some twenty have enacted a competition law so far (see appendix table). All the developed countries in the region – Australia, New Zealand, Japan and Israel – have quite a long history of such a regime. Some developing countries, namely, India, Pakistan, Sri Lanka and Lebanon, also have a reasonably long history of competition policy. Interestingly, the so-called newly industrialized countries (NICs) did not develop with a competition law in place – the Republic of Korea enacted such a law in 1980 and Taiwan Province of China in 1991, but Hong Kong, China, and Singapore do not as yet have a comprehensive competition law.

… but implementation has been weak

On the face of it, there seems to be no obvious connection between the existence of competition legislation and rapid economic growth. However, it may be rather naive to say that the NICs did not have a competition policy just because they did not have a competition law. There is evidence that these countries used various policy measures to promote competition in the marketplace, reward efficient firms and punish inefficient ones, which is what a properly formulated competition policy does (Khemani and Dutz 1996). Further, they were able to ensure competition through industrial and trade policies. Countries like India, Pakistan and Sri Lanka, however, never implemented their competition laws in an appropriate manner. Enforcement either lacked the necessary vigour or was carried out in a distorted manner. There was undue government intervention on many occasions, especially in Pakistan. In India, the law was made ineffective by manning the body charged with enforcement with inadequately qualified or experienced staff who were also too few in number.

Evidence may not be overwhelming, but indications suggest that competition policy and law are likely to be beneficial to people even in this region (UNCTAD 1997). Furthermore, in this age of globalization, where many anti-competitive practices have a cross-border origin, countries ignore the importance of competition policy and law at their own peril.

Every country needs to tailor its competition law to its own specific set of circumstances

This is not to suggest that "one size fits all" and that countries should adopt either the model used by a developed country or neighbour or one of the models drafted by an international body such as that formulated by UNCTAD. On the contrary, every country needs to tailor its competition law to its own specific set of needs and conditions. The most important factor is that the law should be realistic and implementable. Introducing a law that cannot be properly implemented is not only futile but may be counterproductive. If the competition authority is seen as being incapable of discharging its role, then people may lose faith in the effectiveness of competition law as a whole.

Modern competition law requires giving a great deal of discretion to the competition authority

While the public in developing countries may appreciate the role of competition law in checking anti-competitive practices, people are also apprehensive that a competition authority vested with enormous discretionary power may not function in a predictable and transparent manner. Modern competition law and the authority that enforces it have to be discretionary in their approach. Removing discretionary power through more per se provisions could be even worse (Department of Company Affairs, Government of India 2000).[2]

Exceptions and exemptions to the law should be clearly defined and given with caution

Provisions in the law should be appropriate as well as realistic. There is scope for exceptions and exemptions in the competition law and countries should make careful use of them. If, for example, the national development strategy of a country includes policies to promote small and medium-sized enterprises, disadvantaged regions or groups, then there should be suitable exemptions. However, exemptions should be properly defined and included with caution. At the stage when legislation is being drafted and debated, many interest groups may lobby for exemptions from the law. It is more than likely that these attempts will not be based on any sound arguments of economic

[2] The per se rule is a judicial principle that an act or practice violates legal provisions simply if the act or practice occurs regardless of whether it is harmful or not. In contrast, the "rule of reason" refers to the judicial doctrine that whether an act or practice violates legal provisions is determined on the basis of its impact and/or other factors.

efficiency or consumer welfare but simply to prolong the protection of inefficient businesses from competition.

Monitoring the competition authority may require the creation of an oversight body

Owing to the existing complexities and multiplicity of objectives, developing countries in the region need to maintain exemptions and exceptions. This, coupled with a "rule of reason" approach, would give the competition authority a great deal of discretion. Thus, to ensure that the competition authority does not get overzealous or underperform, guidelines, which should be subject to periodic review by the legislature, need to be properly formulated. Empowering the Government to state policy guidelines from time to time, as has been proposed in the new draft Competition Bill in India, may invite undue government intervention. The Australian example, where a council at the national level comprising different stakeholders deals with the overall policy framework on competition policy and law, is instructive in this regard.

There is a case for separating investigative and judicial functions in competition cases

Another way to avoid overzealous or inadequate implementation of competition law would be to keep investigative and adjudicatory functions separate. Experiences in other jurisdictions, including Europe in recent times, have shown that combining the two functions enables a competition authority to act as judge, jury and executioner. This absolute power strips the system of internal checks and balances, thus leaving scope for its misuse.

Utility regulatory policies

There is no guarantee that good legislation will meet its aims. Creating a competition culture depends on effective implementation and a supportive policy environment. As mentioned above, competition law is just one element of competition policy. The effectiveness of the competition law will depend on the extent to which it is coordinated with other policies. It is beyond the scope of this paper to discuss all of them, but a brief discussion on regulatory policy may not be out of place.

The boundaries between the competition authority and sectoral regulators are sometimes blurred

The competition authority has the most direct overlap with regulators governing key utility sectors that usually have the mandate to create, promote and protect competition in these industries. Sectoral regulators are established where there is a natural monopoly or typically the possibility of market failure is high. The idea is to regulate firms in these industries in such a way that even when a competitive market cannot be ensured, the outcome in terms of prices and output will be nearly the same as if the market had been competitive. The boundaries between the roles of the sectoral regulators and the competition authority are difficult to define and in many countries the issue remains unresolved.

Anti-competitive practices in a regulated industry should fall within the purview of the competition authority

Ideally, the sectoral regulators should concentrate on tariffs and the setting of performance standards. The role of the competition authority would be to deal with the abuse of dominance and other anti-competitive practices when they arise. In any case, the competition authority should have the upper hand in competition matters, especially in smaller economies, as sectoral regulators are more exposed to groups of business people in their industries and hence more prone to regulatory capture.

International dimensions of competition policy

As trade and investment regimes are liberalized in most developing countries, the inflow of foreign products and companies creates new challenges for competition policy. While Governments regulate domestic markets through various measures, including a competition regime, there is little regulation of international markets. Added to this complexity, very few people in developed and developing countries appreciate the international dimension of competition policy and its integral relationship with trade and consumer welfare, and national economic development.

A national competition regime is only a first step in dealing adequately with cross-border competition issues

In order to face these challenges, countries require, in the first place, a national competition regime, backed by adequate resources. This would allow them to investigate and prosecute anti-competitive behaviour by transnational corporations operating in the domestic economy and to regulate them as appropriate. However, developing country competition authorities, in general, do not have the resources or the experience to tackle international competition challenges. Cartel cases are notoriously difficult to prove, even for the American and European authorities dealing with companies based in their territories. It will therefore be almost impossible for a developing country to carry out the tedious casework involved and conduct the necessary investigations leading to prosecution.

Cooperation agreements in the competition arena are best pursued in a multilateral framework

One way is to have cooperation agreements with developed countries. This can best be done in a multilateral framework, rather than on a bilateral basis, because of the sheer number of bilateral agreements that would be needed. Proposals for a multilateral framework, where cooperation is a major issue, are currently under discussion at UNCTAD and WTO. Several other initiatives are also being pursued in various forums, to build capacity in developing countries and enable discussions among lawyers dealing with competition issues in various countries.[3] High-level policy dialogue to develop mutual understanding, identification of “best practices” and provision of informal advice and feedback on the entire range of competition policy issues are other aims.

Within the Asia-Pacific region, an initiative has been made under APEC

Various regional initiatives are also in place. In the Asian and Pacific region, a working group on competition policy and deregulation was set up under Asia-Pacific Economic Cooperation (APEC) to discuss competition policy and issues of deregulation. APEC’s most important and substantive output in the competition policy field has been the APEC Principles to Enhance Competition and Regulatory Reform, adopted at a ministerial meeting in 1999.

[3] These include the International Bar Association’s Global Forum for Competition and Trade Policy, the OECD Global Forum on Competition and the International Competition Network.

WTO seems to be the most active forum tackling international competition policy issues

There is a growing consensus that there is a case for a multilateral competition framework, but there is by no means any agreement on what its scope and contours should be and on where the body to enforce it should be situated. UNCTAD has a long history of working on competition policy and could be a non-controversial forum for anchoring a multilateral competition agreement. However, it has very little background in negotiating international issues, except for commodity agreements, and it has no enforcement mechanism. The issues pertaining to competition were included in the Uruguay Round negotiations, although no separate agreement on trade and competition policy was negotiated. Three WTO Agreements contain provisions related to competition policy, namely Trade-Related Investment Measures (TRIMs), the General Agreement on Trade in Services (GATS) and Trade-related Aspects of Intellectual Property Rights (TRIPs). The Ministerial Declaration signed at Doha refers to further work to be undertaken by the Working Group on the Interaction between Trade and Competition Policy related to core principles on transparency, non-discrimination, procedural fairness and recognition of the ills of hard-core cartels. It also includes the development of flexible cooperation modalities and technical cooperation. Five years after its introduction in the WTO arena through the Singapore Ministerial Declaration in 1996, members have finally recognized the case for addressing these competition policy issues and there are possibilities that negotiations may be launched after the Fifth Ministerial Meeting, to be held in November 2003.

Creating a competition culture

Competition law is subject to appropriate adaptation depending on local needs, aspirations and socio-economic, cultural and legal conditions. Traditionally, competition law and the competition authorities deal with issues that fall under three broad headings:

- Control of monopoly or abuse of dominance;
- Restrictive trade practices and other anti-competitive agreements;
- Regulation of combinations such as mergers, acquisitions and takeovers.

It can be argued that competition advocacy should be given equal weight with any of the three traditional functions.

Competition advocacy has not received as much attention as it warrants

A healthy competition culture is the hallmark of a good competition regime and competition advocacy is a basic prerequisite for this. The lacklustre performance of competition policy and law in many countries in the Asian and Pacific region is primarily due to the failure to recognize the importance of competition advocacy. A properly designed advocacy programme plays an important role in discouraging and sometimes eliminating anti-competitive practices. As prevention is always better than cure, advocacy not only reduces the incidence of anti-competitive practices but also substantially reduces the need for enforcement action, thus saving costs on both counts. In this regard it is extremely important that civil society, especially consumer organizations, be closely involved in the advocacy efforts of the competition authorities. This will give not only better outreach but also acceptability as there is a danger otherwise that the efforts of the competition authorities may be taken as a mere publicity drive.

An active consumer movement could play an important role in making competition laws effective

An active consumer movement makes a significant difference to the effectiveness of competition law in other ways also. Empowered consumers and representative organizations will bring anti-competitive practices, including abuse of dominance and collusion, to the attention of the competition authority. They will also act as a countervailing power to businesses to ensure successful implementation of competition law. Thus, competition law should also include the right of consumer organizations to bring complaints to the competition authority. This would also help to deal with resource problems, where the competition authority's budget limits investigative capacity. Consumers also need to be included in the consultative process for policy questions. Putting the consumer at the heart of the legislation makes it more likely that the benefits of competition policy and law will be shared widely (CUTS 2002).

Competition advocacy may require developing a consumer movement that would benefit other areas of development policy

Many consumers are not aware of the relevance of competition policy, and consumer organizations have an important role in demonstrating the importance of competition policy by linking it to everyday experiences with which people are familiar. However, the consumer movement is not yet well developed in many countries of the region. That is a concomitant task for building a healthy competition culture. One important spin-off of developing a consumer movement is its impact on the whole economic agenda of the country: consumers generally support reforms so as to get better goods and services at lower prices and good governance to ensure that the systems work effectively.

A countervailing force to business lobbying could come from the increased awareness of consumers

Unfortunately, firms are better organized and financed, and often act as a powerful constituency against competition policies and laws, which directly affect their interests. In fact in many countries of the region, such as Thailand or Indonesia, enforcement of a competition law would meet with strong pressure from the business lobby. In India the business lobby has worked hard against the enactment of a new, modern competition law. Thus, a strong and vibrant consumer movement is an important factor in the success of legislation on competition. It can also check undue interference on the part of the Government in the affairs of competition and regulatory authorities, which otherwise is so prevalent in the region.

Appendix table. Enactment of competition law in Asia-Pacific countries

	Year of enactment
Australia	1906
New Zealand	1908
Japan	1947
Israel	1957
Lebanon	1967
India	1969
Pakistan	1970
Thailand	1979
Republic of Korea	1980
Sri Lanka	1987
Cyprus	1989
Kazakhstan	1991
Taiwan Province of China	1991
Fiji	1992
Uzbekistan	1992
China	1993
Tajikistan	1993
Kyrgyzstan	1994
Turkey	1994
Georgia	1996
Indonesia	1999
Azerbaijan	In Process
Jordan	In Process
Malaysia	In Process
Mongolia	In Process
Nepal	In Process
Philippines	In Process
Viet Nam	In Process
Turkmenistan	In Process

***Note*:** Prepared by CUTS from various sources. Some other countries may also be in the process of enacting a competition law and may have been inadvertently omitted here.

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VIII REGIONAL FINANCIAL COOPERATION IN EAST ASIA: THE CHIANG MAI INITIATIVE AND BEYOND[1]

The East Asian financial crisis and regional cooperation

Globalization has brought greater volatility to financial markets

It goes without saying that countries in East Asia[2] have benefited greatly from the globalization of financial markets. Starting from the mid-1980s, large inflows of capital helped to finance the vigorous economic growth of the region. However, with rapid globalization, the volatility of these markets and the concomitant risks for developing countries have increased drastically. The shift in market perception that heralded the onset of the East Asian financial crisis in July 1997 led to capital outflows from the region amounting to US$ 150 billion in the subsequent three months, whereas inflows had been US$ 100 billion the preceding year. The unprecedented scale of the reversal of external flows caused enormous damage to countries in the region as it was followed by sharp depreciations of real exchange rates, precipitous falls in asset prices, collapses in investment and in consumer confidence, and the destruction of incomes. With such a self-reinforcing financial collapse, even a developed country with a basically sound economic system would have been unable to protect itself.

The 1997 crisis forced a reconsideration of the ability of Governments to manage globalized financial flows

The financial crisis in 1997 was a wake-up call to East Asian Governments that their financial markets and institutions were insufficiently prepared to manage globalized capital flows. Financial institutions had to be reformed and restructured, capital markets broadened and deepened, and supervision and regulation standards brought up to international best practices. In addition, the success of the Japanese-led financial support package for Thailand in September 1997 encouraged Governments to consider establishing regional financial facilities, as in their view the provision of international financial help through existing multilateral arrangements had been neither timely nor sufficient to put a rapid end to the crisis. Not only were the East Asian countries discontented with the IMF approach, but there was also a growing consensus among them that a collective response to similar critical situations

[1] Prepared by Seok-Dong Wang, Economic Affairs Officer, and Lene Andersen, formerly Associate Economic Affairs Officer, Development Research and Policy Analysis Division, ESCAP.

[2] East Asia is defined here as comprising the countries of ASEAN plus China, Japan and the Republic of Korea, i.e., the group more commonly known as ASEAN+3.

in future would be necessary because of their growing regional integration, evidenced in part by the mutual susceptibility to contagion.[3]

The Chiang Mai Initiative was born from measures to improve regional self-protection

The self-protection measures by and for the East Asian countries first took shape in the form of the Manila Framework Group in November 1997, which was set up as a forum for regional economic surveillance and crisis management that aimed at strengthening the role of IMF. Its membership consists of 14 Pacific nations. Subsequently, the ASEAN Surveillance Process was established in 1998 with the overall objective of strengthening policy-making capacity within the grouping. Peer review and surveillance were extended to cover not only the major macroeconomic aggregates but also sectoral and social policies so as to improve policy coordination in the broadest sense, particularly in the light of adverse developments. Finally, in May 2000, the finance ministers of ASEAN+3 countries reached agreement on the Chiang Mai Initiative (CMI), which was the first significant regional financing arrangement to enable countries to cope with disruptive capital flows and maintain exchange rate stability.

CMI raises many important issues

CMI raises several important issues, such as its likely effectiveness in bringing about exchange market stability in member countries; its relationship with IMF; and the possibility of its evolution towards an Asian monetary fund and a new regional financial architecture. After a brief description of CMI, the discussion in this paper will focus on these issues as well as provide perspectives on further economic integration in the East Asian region.

The Chiang Mai Initiative

Quick activation and disbursement are the hallmarks of CMI

The Chiang Mai Initiative was designed to expand the existing ASEAN Swap Arrangement (ASA), by extending its coverage to all members of ASEAN and by increasing the size of the swap arrangements, and to create a network of bilateral swap agreements (BSAs) between the countries of ASEAN+3. ASA, first established in August 1977, was designed to alleviate temporary liquidity shortages among central banks in member countries, and the facility has been extensively used.[4] Since pre-emptive measures are very important in the battle against a speculative currency attack, quick activation and disbursement are essential and the funds available under ASA and the first 10 per cent of the drawing available under the BSAs are unconditional. Under the expanded ASA, the Agent Bank, whose appointment is subject to rotation among the members, has the task of confirming a request for liquidity and assessing and processing it as expeditiously as possible in consultation with other member banks. Member banks are allowed to swap their own currencies for major international currencies for a period of up to six months

[3] See the appendix table for an indication of intraregional trade dependence in the ASEAN+3 countries.

[4] The original agreement was signed by Indonesia, Malaysia, the Philippines, Singapore and Thailand.

and for a sum up to twice the amount committed by the member under ASA (Manupipatpong 2002: 116).[5]

The network of bilateral swap arrangements between ASEAN+3 countries is almost complete

The network of bilateral swap arrangements and repurchase agreement facilities[6] so far established is shown in table 1. The idea is that a country under speculative attack can borrow foreign currency, usually the United States dollar, from another country and use the funds to buy its own currency so as to stabilize the exchange rate. The BSAs thus involve a credit risk. The general terms of borrowing are a maturity of 90 days, renewable up to a maximum of seven times, with interest to be paid at a rate based on the London Inter-bank Offered Rate (LIBOR) plus a spread.[7] Although the maximum amount of the automatic disbursement, which is free of any linkage to an IMF programme or conditionality, is currently limited to 10 per cent of the BSA facility, additional assistance can be provided to members requesting it under an IMF programme or an activated Contingent Credit Line.

Table 1. Bilateral swap arrangements under CMI (as of October 2002)

	Currencies	*Maximum drawing*
Japan & China	Yen-yuan renminbi	US$ 3.0 billion equivalent
Japan & Malaysia	US dollar-ringgit	US$ 3.5 billion*
Japan & Philippines	US dollar-peso	US$ 3.0 billion
Japan & Republic of Korea	US dollar-won	US$ 7.0 billion*
Japan & Singapore	US dollar-Singapore dollar	Under negotiation
Japan & Thailand	US dollar-baht	US$ 3.0 billion
China & Malaysia	US dollar-ringgit	US$ 1.5 billion
China & Philippines	US dollar-peso	US$ 3.0 billion under negotiation
China & Republic of Korea	Yuan renminbi-won	US$ 2.0 billion equivalent
China & Thailand	US dollar-baht	US$ 2.0 billion
Republic of Korea & Malaysia	US dollar-ringgit	Under negotiation
Republic of Korea & Philippines	US dollar-peso	Under negotiation
Republic of Korea & Thailand	US dollar-baht	US$ 1.0 billion

Sources: <http://www.mof.go.jp/jouhou/kokkin/pcmie.htm> (Ministry of Finance, Japan, 28 March 2002) and other country-specific web pages.

* Including a dollar-won swap arrangement of US$ 5 billion and a dollar-ringgit swap arrangement of US$ 2.5 billion from the New Miyazawa Initiative.

[5] Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand have committed US$ 150 million each; Viet Nam has committed US$ 60 million; Myanmar US$ 20 million; Cambodia US$ 15 million; and the Lao People's Democratic Republic US$ 5 million.

[6] The seller of securities, particularly government bonds, agrees to repurchase them at an agreed price and date, essentially obtaining extra liquidity (short-term loans).

[7] For the first drawing and first renewal the spread is 150 basis points and for every two renewals 50 additional basis points, subject to a maximum of 300 basis points.

The United States dollar remains the dominant currency in the BSAs but local currencies also play a role

Currently the United States dollar is the dominant currency under the BSAs with the exception of the China-Japan and China-Republic of Korea arrangements, which will be denominated in local currencies. Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam have been given some flexibility for gradual accession to the Arrangement.[8] Details on the phasing-in mechanism are still under consideration.[9]

The efficiency and effectiveness of CMI

CMI may help countries to economize on foreign exchange reserves thus increasing efficiency

After the Asian financial crisis, most countries in the region started to build up their foreign exchange reserves, quite dramatically in some cases (table 2). The main justification seems to be to ensure themselves of the liquidity needed in the event of a future speculative currency attack.[10] The build-up in reserves has occurred even though exchange rate regimes in the region are now much more flexible (see the appendix table) and the resources available to IMF have greatly increased and new lending facilities have been established. It can be argued that the large size of these reserves, in relation

Table 2. Post-crisis developments in international reserves in ASEAN+3 countries

(Billions of US dollars, end-year)

	1996	*Mid-1997*	*End-1997*	*1998*	*1999*	*2000*	*2001*
Cambodia	0.3	0.3	0.3	0.3	0.4	0.5	0.6
China	107.0	122.8	142.8	149.2	157.7	168.3	211.8
Indonesia	18.3	20.3	16.6	22.7	26.4	28.5	27.3
Japan	216.7	221.1	219.6	215.5	286.9	354.9	395.2
Lao People's Democratic Republic	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Malaysia	27.0	26.6	20.8	25.6	30.6	29.5	30.5
Myanmar	0.2	0.2	0.2	0.3	0.3	0.2	0.4
Philippines	10.0	9.8	7.3	9.2	13.2	13.1	12.6
Republic of Korea	34.0	34.1	20.4	52.0	74.0	96.1	102.8
Singapore	76.8	80.7	71.3	74.9	76.8	80.1	76.5
Thailand	37.7	31.4	26.2	28.8	34.1	32.0	32.3
Viet Nam	1.7	..	2.0	2.0	3.3	3.4	3.7

Source**:** IMF, *International Financial Statistics*, various issues.

[8] Cambodia, the Lao People's Democratic Republic and Viet Nam are also currently under the IMF Poverty Reduction and Growth Facility, which "... provides longer-term assistance for deep-seated balance of payments difficulties of a structural nature and aims at sustained poverty-reducing growth" (IMF 2001: 38).

[9] Refer to <http://www.mfa.go.th/dea/chiangmai%20initiative.htm> for more details.

[10] In addition to increasing the absolute size of the foreign exchange reserves, the countries have also been paying careful attention to managing the usable amounts of the reserves, as some of these reserves were locked in various financial products or other commitments during the financial crisis and could not be mobilized for protecting their economies when needed.

to trade and to GDP, is inefficient and reflects concern about access to IMF resources on acceptable terms (Henning 2002: 5). Despite the importance of foreign exchange reserves in maintaining investors' confidence and managing exchange market pressure, countries should seek to balance the opportunity costs of holding large amounts of reserves against the perceived benefits. One of the ways to reduce the costs of holding reserves, which tend to increase with the growing volume of international financial transactions, is for a group of countries to pool a portion of their reserves to create new credit facilities for themselves. In this respect, it can be said that CMI has enabled ASEAN+3 countries to improve efficiency in the use of financial resources.

In the 1997 financial crisis, IMF and lender nations granted the Philippines US$ 1 billion; Thailand US$ 17.2 billion (of which US$ 9.5 billion came from ASEAN+3 member countries); Indonesia US$ 42.3 billion (of which US$ 13 billion came from ASEAN+3 member countries); and the Republic of Korea US$ 58.4 billion (of which US$ 10 billion came from Japan).[11] Clearly, the amount of liquidity currently available through CMI is small relative to the size of past financial rescue packages for the East Asian crisis-hit countries. Furthermore, the current maximum amount that can be provided to a country in distress under the CMI swap arrangements is a drop in the ocean compared with the amounts that global financial markets can mobilize and thus its effectiveness in stabilizing exchange markets is open to question.

The swap arrangements under CMI are small but send a strong signal to financial markets

Their size notwithstanding, the swap arrangements have a strong symbolic effect as a signal to market participants that liquidity is immediately available and can be extended, if necessary, by the ASEAN+3 member countries themselves, together with the assistance from IMF. The swift availability of liquidity, together with the exchange of information among member Governments on the size and origin of capital movements, helps in curbing currency speculation and in countering investors' herd behaviour, often observed when markets turn down. In this sense, it contributes to reducing the volatility of market sentiment. Although the amount of liquidity that can be quickly mobilized is currently small, it may be increased in the near future through further negotiations among the ASEAN+3 member countries, whose combined foreign exchange reserves are currently estimated (table 2) to be as much as US$ 900 billion.[12] In this sense, it can be said that the effectiveness of CMI can only improve, if further cooperation, backed by the political will of the member Governments, is forthcoming.

[11] Indonesia is also currently under the IMF Extended Fund Facility, which provides "… longer-term assistance to support members' structural reforms to address balance of payments difficulties of a long-term character …" (IMF 2001: 38); the Philippines and Thailand recently concluded Post-Programme Monitoring Discussions with IMF (i.e., the arrangement has expired, but there are still credits outstanding) and Thailand began repayment in late 2000; the Republic of Korea repaid the final installment of its outstanding credits in August 2001 <http://www.imf.org/external/country/index.htm>.

[12] For example, if ASEAN+3 member countries would agree to pool 10 per cent of their foreign exchange reserves, additional liquidity of US$ 90 billion would be available to serve as "first-aid" funds for stabilizing the markets.

The relationship of CMI and IMF

In 1997, the four crisis-hit East Asian countries (Indonesia, the Philippines, the Republic of Korea and Thailand) had to seek international financial rescue. From the viewpoint of these countries, the help provided was neither swift nor sufficient to pacify turbulent markets, and the policy prescriptions imposed by IMF conditionality caused the economies of the affected countries to sink into unprecedentedly deep and enormously painful recessions. When speedy measures were needed, the negotiation of conditionality requirements with IMF took time, and the news that assistance was being sought actually aggravated the situation as it shook investor confidence further. By the time the assistance package finally took shape, a great deal of damage had already been done and restoration of confidence took a long time.

CMI has found a compromise with IMF conditionality so as to minimize moral hazard

Part of the problem was that countries in distress tended to postpone approaching IMF for liquidity assistance as long as possible in order to avoid the austere IMF conditionalities and the associated loss of confidence. The unconditional and immediate disbursement of some of the funds available under CMI swap arrangements is a partial answer to these concerns. However, the requirement that countries needing assistance beyond the initial 10 per cent available under the BSAs accept a linkage to IMF conditionality is something of a compromise. In this sense, the swap arrangements under CMI can be said to be supplementary to the existing IMF financing facilities. The linkage to IMF conditionality requirements provides some comfort to lenders as it limits the moral hazard problem, together with the progressive interest rate structure; but it also leaves open the danger that sufficient swap funds will not be available until it is too late.

Complementarity to existing multilateral arrangements is the key to developing regional financial facilities

In September 1997, Japan proposed the idea of creating an Asian monetary fund (AMF) that would supplement IMF resources for crisis prevention and resolution. Among Asian countries discussions had been taking place that a regional fund could have a comparative advantage in diagnosing regional economic problems and prescribing appropriate solutions, and that pluralism would increase competition and yield better results in the market for ideas. Some doubts were also cast on the effectiveness of international standards and the legitimacy of imposing them on developing countries, on the grounds that perhaps there was no universal best practice. International standards were neither closely aligned with regional interests nor sensitive to regional conditions or needs. The AMF proposal, however, met with stiff opposition from the United States and IMF, on the grounds that it could encourage countries to postpone needed restructuring measures, and it came to nought. After some vicissitudes, the idea of AMF was reformulated and modified to a simpler form of swap arrangements and more recently IMF has appeared to be willing to accommodate the trend to regionalization as long as it is not pursued in opposition to IMF but in a complementary fashion.

Further refinement of CMI

A strong regional surveillance system is needed to improve the effectiveness of the network of BSAs

The swap arrangements are intended to be a preventive measure for providing support for the balance of payments and short-term liquidity. In this sense, they are similar to the IMF Emergency Financing Mechanism, which is to be used only in circumstances representing, or threatening to give rise to, a crisis in a member's balance of payments requiring an immediate IMF response.[13] If CMI is to function effectively, providing added value to existing mechanisms, the network of BSAs will need to establish a very good regional surveillance system, as well as a coordinating and decision-making process for speedy activation and disbursement of swaps.

Adherence to reasonably strong macroeconomic criteria for non-crisis periods will go far in stabilizing exchange markets

Further, it could be argued that it would make CMI more effective and acceptable if certain policy conditionality requirements were specified in advance before liquidity is needed to save time in conducting the swap procedure. IMF introduced in 1999, and revised in 2000, Contingent Credit Lines for member countries not at risk of an external payments crisis of their own making but vulnerable to contagion effects from capital account crises in other countries, assuming that these countries were already fulfilling key requirements regarding the fiscal balance, economic growth, inflation, capital flows, international reserves, the current account balance and the soundness of the financial system. In either the ASEAN+3 or the IMF context, policy conditionality could be defined and incorporated in monetary cooperation along the lines of aiming to meet the criteria for non-crisis periods, so enhancing the effectiveness of the mechanism. Adhering to or aiming at fulfilling reasonably strict criteria for non-crisis periods would add to the stability of a country and so contribute to lowering its risk premium in international capital markets, thereby giving the country an incentive to comply. If a crisis still occurred, interim financing could become available immediately without the need to implement normal IMF conditionality, since presumably these countries would have met such conditions beforehand. In effect, it might even help in furthering regional financial and monetary cooperation.

Perspectives on regional cooperation in East Asia beyond the swap arrangements

The concept of monetary and financial cooperation can range from swap arrangements to a full monetary union, with various stages in between. Hence, there are wide-ranging considerations regarding the possible evolutionary paths from the current situation to an East Asian monetary fund, not the least of which is the implicit choice of exchange rate regime.

[13] It is also similar to the IMF Supplemental Reserve Facility (SRF) established in December 1997 to provide financial assistance to members experiencing exceptional balance of payments difficulties due to short-term financing needs resulting from a sudden and disruptive loss of market confidence, reflected in pressure on the capital account and the member's reserves. SRF is to be used in cases where the magnitude of the outflows may create a risk of contagion that could potentially threaten the international monetary system.

Although the Chiang Mai Initiative is often viewed as potentially being the foundation of a monetary system for East Asia, it is premature to say whether this will, in fact, be the case in the near future.

Regional financial integration is still a distant goal despite the creation of CMI

The recent liberalization and deregulation of financial markets in East Asian countries has driven them to closer integration into global financial markets rather than strengthening regional financial integration. Differences in the stages of development and in the legal and regulatory environments between countries in the region have so far hampered greater financial integration. Increased economic convergence, combined with the adoption of international best practices in terms of financial legislation and regulation, may eventually generate a situation conducive to the creation of an AMF. However, the huge gap in financial expertise, technology, infrastructure and market size between the emerging markets of East Asia and the international financial centres in developed countries has led to a situation where financial services in the region are increasingly being provided by international corporations. This could have the effect of preventing sufficient expertise from being built up in the region and also limit the extent to which regional identification develops as a driving force.

The creation of free trade areas is now the focus of interest

After having achieved some tangible results through the creation of CMI, the focus of interest of ASEAN+3 member countries seems to have shifted from regional financial and monetary cooperation to the establishment of free trade areas (FTAs). The ASEAN Free Trade Area (AFTA) is now in operation, while China and ASEAN are soon to sign an agreement creating an FTA within 10 years. Japan has an FTA with Singapore and is pursuing closer economic partnerships with other countries in the region. The Republic of Korea and Thailand are also in discussions on establishing an FTA. The final outcome of these developments will depend on the political will and economic goals of the Governments concerned. There could be an ASEAN+1, an ASEAN+2 or even an East Asian Community comprising ASEAN+3 countries. Were a North-East Asia FTA to emerge, it could provide a strong impulse to further regional integration, alongside the global integration process now taking place.

Japan's leadership role is diminishing as economic problems linger

However, there are some barriers on the path to broader integration of East Asian countries. First, Japanese commercial banks have reduced their lending to other East Asian countries, and Japanese investment banks have been driven out of the financial services markets as a result of protracted financial problems. Thus, the role of Japan as the leader in the creation of an East Asian economic entity has diminished and the yen is declining in importance as an international currency. Second, China is growing fast and expanding its trade relations with neighbouring countries including ASEAN, but its currency and banks are not quite ready as yet for international business transactions. Forging a consensus on greater economic and financial integration is likely to be more difficult in an increasingly bipolar East Asian region. An economic revival in Japan and closer Sino-Japanese economic and financial ties would advance regional integration considerably. Nevertheless, the greater diversification in Governments, levels of economic development and history of the region than was present in the case of Europe, for example, suggests that the integration process in East Asia will have to chart its own course and will need considerable time. Further, no serious consideration has yet been given to the possible evolution of CMI into a regional mechanism for exchange rate coordination. Thus, at this stage, it would be desirable and more appropriate for the CMI member countries to focus on areas where consensus is most likely to be reached and to start from there in expanding cooperation further.

Summary

Based on the discussion above, the following conclusions can be highlighted:

- The experience of the 1997 financial crisis suggests that the size of the swap arrangements in CMI may not be commensurate with the amounts that global markets can mobilize. However, these arrangements should be considered to be complementary to existing IMF facilities. Further, they have an important symbolic value in terms of the signal they give to markets of a regional commitment to support a currency under attack. In this respect, it is relevant to note that the region was able to raise substantial liquidity to supplement the IMF disbursements during the crisis.

- Other countries in the Asian and Pacific region may be interested in copying CMI, although its effectiveness in the face of a looming crisis remains to be tested.

- Establishing swap arrangements does not supersede addressing structural and financial sector weaknesses. The Argentine crisis is a case in point. It is desirable that countries aim at fulfilling reasonably strict criteria (prudent budgets, low inflation, strong banking systems, low levels of short-term debt, and so on) in normal times, which will actually reduce their exposure to a crisis. Should a crisis still occur, the disbursement of swaps can be speeded up and some comfort provided to lenders, as conditionalities will already have been met. It is important to note that there has to be room for manoeuvre in the event of a crisis; for example, expansionary fiscal policy might be justified even if it means breaching the criterion on prudent budgets temporarily.

- The Chiang Mai Initiative of the ASEAN+3 countries has contributed to improving exchange rate stability and in doing so may also have contributed to closer regional economic and financial integration. However, much work remains to be done in this regard, not least in strengthening the network of bilateral swap arrangements.

Appendix table. Intraregional trade dependence in ASEAN+3 countries

	Trade (percentage of total in 2000)			*Exchange rate regime*
	ASEAN+3	*Japan*	*United States*	
Brunei Darussalam	74.2	29.5	11.6	Currency board peg to Singapore dollar
Cambodia	32.5	2.5	27.8	Managed float
China	33.1	17.5	15.7	Fixed peg to US dollar
Indonesia	50.6	20.7	12.4	Float
Japan	31.0	..	25.3	Float
Lao People's Democratic Republic	74.9	3.0	1.2	Managed float
Malaysia	49.4	16.7	18.8	Fixed peg to US dollar
Myanmar	53.4	7.4	10.6	Fixed peg to US dollar
Philippines	39.4	16.6	23.9	Float
Republic of Korea	36.7	15.7	20.2	Float
Singapore	46.5	12.3	16.2	Managed float
Thailand	47.7	20.5	17.5	Managed float
Viet Nam	56.2	16.3	4.2	Managed float

Sources: IMF, *Direction of Trade Statistics Yearbook 2001*; IMF, "Exchange rate regimes: is the bipolar view correct?", available at <http://www.imf.org/external/np/speeches/2001/010601a.htm>; BIS, *Quarterly Review*, December 2001; and ADB, *Key Indicators of Developing Asian and Pacific Countries 2002.*

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IX EXPORT DIVERSIFICATION IN PACIFIC ISLAND COUNTRIES[1]

Introduction

Although developing countries as a whole have cut their reliance on primary product exports, major regional differences exist

Many developing countries have pursued export diversification as a deliberate growth strategy to insulate themselves from the sharp and unexpected changes in their terms of trade and, by extension, to stabilize domestic incomes and employment. They have, for example, placed greater emphasis on producing manufactures, as well as securing new markets for their products. A recent, comprehensive study from the World Trade Organization (WTO) pointed out that developing countries as a whole have cut their reliance on commodity exports and made remarkable progress in exporting manufactured goods over the past three decades. However, much of this is a reflection of the success of the Asian region in slashing its comparatively low reliance on commodity exports at the start of the 1970s (50 per cent of total exports) even further to less than 15 per cent at the end of the 1990s. Major regional differences still exist (WTO 2002).

Among the least developed countries (LDCs) that had made the transition were Bangladesh and Nepal in the Asia-Pacific region. In particular, the share of manufactures in total exports increased from 46 per cent in 1968-1970 to 91 per cent in 1998-2000 in Bangladesh and from 18 to 69 per cent during the same period in Nepal. The WTO report concluded that the experiences of Bangladesh, Nepal and such other countries as Costa Rica, the Dominican Republic, Mauritius and Morocco showed that being landlocked, small or least developed did not necessarily imply that it was impossible to become an exporter of manufactures. Thus, the main purpose of this paper is to assess in both greater scope and detail the progress made by Pacific island economies, which include several LDCs, in their efforts at export product and market diversification.

Export diversification in Pacific island countries

Pacific island economies are generally open, with high export and import ratios

Pacific island economies are relatively open. They face many inherent constraints in seeking to diversify their exports. These include a scarcity of domestic resources, acute shortages of skilled manpower, a lack of adequate economic infrastructure, geographical isolation from main trading partners and, hence, higher transportation costs. Most of them export a narrow range

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of primary commodities, and the export/GDP ratio is quite high for the larger countries – almost one third in Fiji and Solomon Islands, and about two thirds in Papua New Guinea in 1998-2001. The ratio is much lower in smaller island economies, for example, 6 per cent in Tonga and 16 per cent in Kiribati.

Terms of trade facing the Pacific island countries have been generally adverse for some twenty years

The prices of some major Pacific island commodity exports have fluctuated widely. After peaking in the late 1970s, they have generally been on a declining trend.[2] Meanwhile, rising import prices contributed to the adverse terms of trade of most Pacific island economies from the early 1980s. On the supply side, the high incidence of natural disasters – cyclones, floods, drought, earthquakes and volcanic eruptions and the associated tidal waves – has aggravated the volatility of export supply and hence earnings. Fiji, Solomon Islands, Tonga and Vanuatu experienced several cyclones in the 1980s that extensively damaged infrastructure and destroyed several perennial export crops and livestock. Direct losses were equivalent to several percentage points of GDP. In the case of Vanuatu in 1987 the damage amounted to nearly 90 per cent of GDP (ESCAP 1989: p. 108).

Instability in export earnings has been greatest for countries with the least export diversification

Instability in export earnings is, as expected, highest in countries like Kiribati, Samoa, Tuvalu and the Marshall Islands, which rely very heavily on exports of one or two commodities. In these countries, the average percentage deviation of export revenues from trend was between 30 and 65 per cent between 1980 and 2000 (table 1). Instability was lowest in Fiji, Solomon Islands, Papua New Guinea and Nauru, with Guam, Vanuatu, Tonga, Cook Islands and New Caledonia having intermediate levels of instability.

The negative effects of adverse terms of trade and fluctuations in export earnings on many Pacific island economies have been mitigated in part by foreign exchange from inward tourism, resource rents (for example, fishing and site-leasing fees), large official financial inflows, substantial remittances from nationals working overseas and the largely subsistence nature of their economies. By and large, Pacific island economic performance during the past two decades has been modest (Fairbairn 2001). Extreme poverty in these island economies may have been moderated by universal access to land – the so-called phenomenon of “subsistence affluence” – and attempts to extend the cash economy should serve to complement (e.g., through productivity improvements) and not undermine the subsistence sector (Tisdell 2000).

Diversifying exports is the main opportunity for growth, given the small size of domestic markets

Given small domestic markets, the expansion of competitive exports from agriculture, agro-processing activities and manufacture continues to offer the main opportunity for economic growth and structural transformation, especially for the larger Pacific island countries. For the other smaller and atoll economies, expanding the production of tradable goods and services in the monetary sector is less important than ensuring the security and predictability of the other sources of income and income transfers available

[2] The exception is the price of timber, which peaked in 1993 but has been on a declining trend since.

Table 1. Instability of export earnings in selected Pacific island economies, 1980-2000

(Percentage)

Marshall Islands	64.5
Tuvalu [a]	35.0
Samoa	33.9
Kiribati	31.1
New Caledonia [b]	25.8
Cook Islands [c]	24.9
Tonga	22.1
Vanuatu	21.5
Guam [d]	21.5
Nauru [e]	20.0
Papua New Guinea	17.9
Solomon Islands [f]	17.4
American Samoa [g]	16.7
French Polynesia [b]	14.2
Fiji [f]	14.1

Sources: ESCAP secretariat calculations based on IMF, *International Financial Statistics Yearbook 2001* (Washington, 2001); A DB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001); and United Nations, *Monthly Bulletin of Statistics* (United Nations publication), various issues.

Notes: The measure of instability is given by $(1/n)*\Sigma[\,|(X_t - \hat{X}_t)/\hat{X}_t|\,] * 100$ where X_t is the observed magnitude of export earnings; $\hat{X}_t$ is the magnitude estimated by fitting an exponential trend to the observed values; and n is the number of observations. The vertical bars indicate the absolute values. Accordingly, instability is measured as the average percentage deviation of export earnings from the exponential trend level for the given period.

[a] 1980-1996. [b] 1980-1997. [c] 1985-1999. [d] 1991-1999. [e] 1980-1995. [f] 1980-1998. [g] 1984-1999.

to them (noted earlier) and, if growth in per capita incomes is to be achieved, maximizing their size.

Fiji's economic liberalization has resulted in increased exports of manufactures

Among the Pacific island countries, Fiji has made the greatest progress in liberalizing its economy. Exports are actively encouraged, and while some export taxes are imposed, they are minimal. The currency was devalued in 1987. The successful establishment in 1988 of tax-free zones and the tax-free factory system of investment incentives for export production accompanied these changes. As a result, a total of 133 projects were set up, attracting both domestic and foreign firms. The dominance of garment manufacturing and garment exports, mainly to Australia and the United States of America, can be seen from trade earnings, from less than F$ 1 million in 1985 to about F$ 120 million in 1990 (ESCAP 1993). Garments, which brought in only 18 per cent of total export revenue on average in 1990-1993, have overtaken sugar as Fiji's most important export product and accounted for 27 per cent of total exports during 1998-2001. This trend has transformed Fiji's economic and sectoral structure (table 2).

Table 2. Changes in the product structure of merchandise exports of selected Pacific island countries, 1968-1970 and 1998-2000

(Percentage)

	Primary products		*Manufactures*	
	1968-1970	*1998-2000*	*1968-1970*	*1998-2000*
Fiji	89	53	8	47
Papua New Guinea	95	97	5	3
Samoa	93	97	2	3
Solomon Islands	98	..	0	..
Tonga	98	96	1	4

Source: Extracted from WTO, *Annual Report 2001* (Geneva, 2002).

Although export concentration remains high, the composition of primary products exported has changed in many cases

Generally, the degree of export concentration appears to be high in other Pacific island economies, with most relying on the export of only two or three products. The WTO report referred to earlier indicates that Pacific island countries continue to depend heavily on exports of primary commodities, and the share of primary products in total exports remained around 96-97 per cent in Papua New Guinea, Samoa and Tonga in 1998-2000. The exceptions appear to be Fiji, mentioned earlier, and Tuvalu, where stamps accounted for nearly 83 per cent of export earnings in 1990 (table 3). Agricultural commodities dominate the exports of several Pacific island countries, although their importance varies a great deal. For example, fruit was one of the top three exports from Cook Islands in 1998-2001 but it accounted for only 2.3 per cent of export earnings on average, whereas in Kiribati copra accounted for an average of 58 per cent of total exports in 1998-1999.

Nevertheless, the nature of export product concentration has shifted in several Pacific island countries. Copra was an important commodity to Samoa's economy up to the early 1980s but it was replaced by fish and coconut cream as the two top exports during 1998-2001, with the former accounting for 57 per cent of total exports in the same period. Copra, bananas and desiccated coconut provided 82 per cent of Tonga's export receipts in 1970-1973 but the relative importance of these products was displaced by squash, fish and vanilla beans, which accounted for 70 per cent of exports during 1998-2001, squash alone being responsible for 40 per cent of total export receipts. In Solomon Islands, palm oil has now replaced copra as one of the top three export commodities.

For a long time, copra used to be a major export item for a number of Pacific island countries but Fiji, the Marshall Islands and Samoa have diversified into coconut oil, copra cake and coconut cream. In contrast, the relative importance of fish as an export has been increasing recently in several Pacific island economies while the Marshall Islands has also had some success with exporting pet fish. There is considerable scope for further

Table 3. Changes in the export concentration ratio of selected Pacific island countries

(Percentage)

	Export concentration ratio (top three products) [a]
Cook Islands	
1970-1973	81.3 (Fruit 52.2; Clothing 23.7; Copra 5.4)
1998-2001	92.8 (Pearls 88.8; Fruit 2.3; Clothing 1.8)
Fiji	
1970-1973	63.1 (Sugar 50.5; Coconut oil 6.5; Gold 6.1)
1998-2001	54.4 (Garments 27.1; Sugar 20.6; Gold 6.6)
Kiribati	
1970-1973	99.8 (Phosphates 89.2; Copra 10.7)
1998-1999	63.7 (Copra 57.9; Fish 5.8)
Marshall Islands	
1980-1983	98.3 (Coconut oil 79.2; Copra cake 13.1; Handicrafts 6.0)
1998-2000	39.5 (Coconut oil 18.0; Copra cake 15.6; Pet fish 6.0)
Micronesia, Federated States of	
1990-1993	86.0 (Fish 81.8; Trochus shells/meat 2.3; Banana 1.9)
1998-1999	93.2 (Fish 92.7; Banana 0.5)
Papua New Guinea	
1970-1973	51.3 (Copper 26.9; Coffee beans 15.3; Cocoa 9.1)
1998-2001	74.0 (Gold 33.2; Crude petroleum 29.1; Copper 11.8)
Samoa	
1971-1973	77.6 (Copra 42.4; Cocoa 27.3; Timber 7.8)
1998-2001	71.2 (Fish 57.2; Coconut cream 7.5; Copra 6.6)
Solomon Islands	
1970-1973	92.9 (Timber 46.7; Copra 30.3; Fish 15.9)
1998-2001	80.5 (Timber 47.4; Fish 23.8; Palm oil 9.3)
Tonga	
1970-1973	81.8 (Copra 54.6; Banana 14.6; Desiccated coconut 12.6)
1998-2000	70.1 (Squash 40.1; Fish 26.4; Vanilla beans 3.6)
Tuvalu	
1980-1983	89.9 (Stamps 86.2; Copra 3.7)
1990	100.0 (Stamps 82.6; Copra 16.3; Handicrafts 1.1)
Vanuatu	
1980-1983	45.5 (Copra 35.3; Beef 5.9; Cocoa 4.3)
1998-2001	51.8 (Copra 31.2; Timber 11.3; Beef 9.3)

Source: Calculations based on ADB, *Key Indicators of Developing Asian and Pacific Countries* (Oxford University Press), various issues.

[a] In some cases, only two products are included, where the shares of other products are negligible.

development of the tuna fishery industry although shortage of capacity to exploit fish stocks or to increase domestic value added has limited somewhat the total benefit from the exploitation of fishery resources. The bulk of the skipjack tuna caught in the exclusive economic zones of Pacific island countries, which at times constitutes up to one half of the world harvest of this species, is landed and processed elsewhere.

Some Pacific countries have increased exports of non-agricultural commodities

Some countries have diversified into non-agricultural primary products. For example, copper, coffee and cocoa provided 51 per cent of export revenue in Papua New Guinea during 1970-1973 but their share fell to 20 per cent in 1998-2001. Gold and crude petroleum, which had joined copper as the top three exports for the country in the early 1990s, now account for 74 per cent of total exports. In Cook Islands, the share of the top three exports in 1970-1973 (fruit, clothing and copra) accounted for about 81 per cent of total exports; clothing and copra exports have now virtually disappeared while pearls have become the major export commodity, contributing 89 per cent to total exports in 1998-2001. In other cases, export concentration appears to have actually increased with little or no diversification. The export share of fish from the Federated States of Micronesia rose from nearly 82 per cent in 1990-1993 to over 92 per cent in 1998-2001. The share of the top three exports of Vanuatu (copra, beef and timber) in total exports increased from 41 to 52 per cent between 1980-1983 and 1998-2001.

A number of countries in the Pacific have found export "niches"

From the discussion above, a number of Pacific island countries have apparently found export "niches" for themselves. These include pearls in Cook Islands, garments in Fiji, squash in Tonga, beef in Vanuatu, seaweed in Kiribati, sashimi in the Federated States of Micronesia and pet fish in the Marshall Islands. Several studies have been done on identifying "niche" products (see, for example, A. McGregor in ESCAP 1997, vol. II), although changing technology or consumer preferences can lead to a rapid disappearance of niche markets, as demonstrated in the case of clothing in Cook Islands when some garment producers relocated to Fiji. Furthermore, the production of the same products in several economies, such as squash in New Caledonia and Vanuatu after Tonga's start, can lead to oversupply and disrupt the market.

Market access has not been a problem for the Pacific island countries

Product diversification efforts must go hand in hand with efforts to secure markets for new products. In this connection, market access has not been a major obstacle for Pacific island countries as they have enjoyed preferential market access with duty-free or low duty rates for exports to major industrial countries (ESCAP 1997, vol. I and E/ESCAP/SB/PIDC(4)/1). For example, under the Lome convention, Fiji, Kiribati, Papua New Guinea, Solomon Islands, Tonga, Tuvalu and Vanuatu have duty-free access for most of their products to European Union (EU) markets. In addition, Fiji is provided with a sugar export quota of 200,000 tons to the EU at a price above the world price. At the same time, most Pacific island products have duty-free access to the markets of Australia and New Zealand under the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), while Papua New Guinea also benefits from the Papua New Guinea-Australia Trade and Commercial Relations Agreement.

Nevertheless, export market concentration remains high

As with products, Pacific island economies have a fairly high degree of export market concentration (table 4). Apart from Papua New Guinea, Pacific island countries relied on only two major markets to absorb between 50 and 76 per cent of their exports during 1996-2000. For example, Australia and the EU together accounted for 50 per cent of Fiji's exports while Australia and the United States provided 76 per cent of Samoa's export earnings during 1996-2000. Japan and other major Asian economies between them took 73 per cent of Solomon Islands exports while Japan and the United States were the destination of 71 per cent of exports from Tonga during 1996-2000. Some 56 per cent of Vanuatu's exports went to Japan and the EU in the same period.

Except for Fiji's garment industry, Samoa's automotive wiring harness industry and Papua New Guinea's mining industry, Pacific island countries do not benefit that much from SPARTECA. Australia was the major market for 64 per cent of Samoa's exports, 31 per cent of Fiji's and 26 per cent of Papua New Guinea's during 1996-2000. In fact, exports to Australia from those three Pacific island countries have been increasing since the early 1980s. However, Australia used to account for 34 per cent of Tonga's exports during the early part of the 1980s, but this is no longer the case. Meanwhile, New Zealand was also a major export market for Samoa and Tonga up to 1990 but its share has since dwindled. The decline is particularly sharp in the case of Tonga: New Zealand's share in Tonga's exports fell from 44 per cent in 1981-1985 to just below 10 per cent in 1996-2000.

New trade and economic cooperation agreements may facilitate higher intraregional trade

Intra-Pacific trade may, however, increase in the future. The Pacific Agreement on Closer Economic Relations involving the 16 Pacific Forum members, including Australia and New Zealand, came into force in early September 2002. It sets out the basis for the future development of trade and other economic relations among the member countries. In addition, a separate WTO-compatible Pacific Island Countries Trade Agreement, envisaging the creation of a free trade area over 10 years among the Pacific Forum countries, excluding Australia and New Zealand, is expected to come into force at the end of 2002. Already, the Melanesian Spearhead Group (consisting of Fiji, Papua New Guinea, Solomon Islands and Vanuatu) provides for duty-free and preferential treatment for several products exported from these countries to each other.

Japan has been a major export market for Papua New Guinea, Solomon Islands, Tonga and Vanuatu since the 1990s, absorbing 49 per cent of Tonga's exports in 1996-2000. It is the second largest export market for Vanuatu after the EU, accounting for 24 per cent of Vanuatu's exports in the same period. Most of the exports to Japan are either raw materials (timber or mineral ores) or food products. Other major Asian economies constitute the second most important export market for Solomon Islands, accounting for 31 per cent of its exports, and these countries also took 14 per cent of Papua New Guinea's exports, a share almost as large as that going to Japan and the EU. Forestry products from Solomon Islands and Papua New Guinea were the main exports to these Asian economies during the 1990s.

Table 4. Market concentration of exports and imports of selected Pacific island countries, 1981-1985 and 1996-2000

(Percentage of total exports or imports)

	Exports		*Imports*	
	1981-1985	*1996-2000*	*1981-1985*	*1996-2000*
Fiji				
Australia	11.4	30.6	36.4	44.7
New Zealand	6.3	6.1	15.8	14.3
Japan	3.5	5.0	15.6	5.2
Other Asian economies	12.4	4.6	12.4	17.6
United States	8.6	14.3	4.5	7.7
European Union	28.1	19.6	8.8	4.1
Papua New Guinea [a]				
Australia	10.3	26.4	40.1	52.7
New Zealand	0.9	0.6	5.3	4.1
Japan	31.1	14.0	16.0	7.5
Other Asian economies	9.8	14.2	18.8	23.0
United States	3.3	3.1	8.7	4.6
European Union	40.7	13.5	7	4.3
Samoa				
Australia	9.8	63.8	16.5	22.4
New Zealand	25.6	3.6	29.9	21.4
Japan	2.8	0.3	12.2	12.5
Other Asian economies	1.6	1.9	11.4	4.8
United States	33.6	11.8	11.6	13.6
European Union	12.7	6.2	4.5	3.8
Solomon Islands [a]				
Australia	2.5	1.7	34.4	39.2
New Zealand	1.2	0.6	8.3	6.0
Japan	44.4	41.7	16.4	8.8
Other Asian economies	8.1	31.0	23.3	24.6
United States	7.6	1.0	3.8	2.7
European Union	26.4	17.3	5.9	3.7
Tonga				
Australia	33.8	1.6	28.0	23.8
New Zealand	44.0	9.8	36.9	34.6
Japan	0.1	49.2	8.0	8.3
Other Asian economies	1.4	0.0	7.9	0.6
United States	5.8	21.3	6.3	13.0
European Union	3.2	1.6	4.4	0.8
Vanuatu				
Australia	0.6	1.0	30.5	21.2
New Zealand	0.1	0.0	9.0	5.1
Japan	7.5	23.6	11.2	37.0
Other Asian economies	2.5	9.8	11.7	10.9
United States	13.4	12.1	0.9	7.1
European Union	43.6	32.8	12.5	5.8

Source: Calculations based on IMF, *Direction of Trade Statistics Yearbook* (Washington), various issues.

Notes: Other Asian economies include China; Hong Kong, China; Indonesia; Malaysia; the Philippines; the Republic of Korea; Singapore; and Thailand. The European Union comprises Belgium; Denmark; France; Germany; Greece; Ireland; Italy; Luxembourg; the Netherlands; Portugal; Spain; and the United Kingdom. Effective 1 January 1995, the European Union also includes Austria; Finland; and Sweden.

[a] Imports are free on board.

Fiji and Vanuatu have had most success in exporting to the United States and the EU

The United States, which has maintained its position as the third most important market for Vanuatu (although its share in that country's exports has declined somewhat), accounted for 6-9 per cent of exports from Fiji and Tonga in the early 1980s. It has now emerged as a very important export market for both countries; in 1996-2000, it was the third most important market for Fiji, accounting for over 14 per cent of exports, and the second largest market for Tongan exports, with an export share of over 21 per cent. Exports from Fiji to the United States were once dominated by a small sugar quota but increased substantially as a result of the trade preference granted in the early 1990s under the Multifibre Arrangement whereby small producers of garments have been normally exempted from quotas.

Meanwhile, the EU has been declining as a major market for Pacific island exports, except for Fiji and Vanuatu. For example, Papua New Guinea's exports to the EU went down from 41 per cent during the early 1980s to 14 per cent during 1996-2000, while those from Solomon Islands went from 26 to 17 per cent in the same period.

Pacific island countries are more reliant on Australia and other Asian economies for imports

Australia has long been the major source of imports for many of the Pacific island economies, and its importance has increased significantly except in Tonga and Vanuatu. In contrast, New Zealand has had a relatively small import share except in Fiji, Samoa and Tonga, and its share also declined in the latter two countries. Asian economies are more important as suppliers of imports than as markets for exports for Pacific island countries with the exception of Papua New Guinea, Solomon Islands and Vanuatu. They have a significant import share in many Pacific island countries and saw this share increase quite sharply in Fiji and Papua New Guinea. However, their share in the imports of Samoa and Tonga was eroded considerably and the United States has become much more important in sourcing imports into these countries. Imports from Japan have tended to decline, except for Samoa, where they have remained fairly stable, and Vanuatu, where they have increased sharply.

Conclusions

It is clear that the larger Pacific island countries continue to rely on primary products for the bulk of their export earnings. Even Fiji, which managed to increase significantly the share of manufactures in total exports, is still very much dependent on primary products. By and large, exports from most Pacific island countries are still highly concentrated in terms of both products and markets and, as a result, these countries remain very vulnerable to fluctuations in world commodity prices.

Developing a sustainable tourism industry may be a promising avenue

Some Pacific island countries have been successful in developing niche export products and these countries should continue to pursue such initiatives. In addition, Pacific island economies should also explore ways of diversifying exports by developing services, such as a sustainable tourism industry, which would utilize their rich traditional cultures. They should also explore new markets for their exports, in addition to efforts to penetrate current markets further. In particular, Asian economies offer great promise in this context, given their geographic proximity and growing middle class, especially now that China has joined WTO.

The subsistence sector should be strengthened in tandem with export diversification

Measures to encourage export diversification need to viewed in a broader context, however. Given the crucial role of the subsistence economy in sustaining livelihoods in these island economies, government measures to promote the cash economy have to be pursued in tandem with efforts to strengthen the subsistence sector. In addition, resource and other constraints have to be addressed, as has the issue of efficiency in the utilization of aid. It is, furthermore, essential to maintain political stability and pursue appropriate macroeconomic policies to ensure price stability and an exchange rate that does not discourage export initiatives. A greater role for the private sector, including the provision of support services such as marketing to facilitate this, would be helpful in this regard. However, developments at the international level, including the outcomes of WTO negotiations on the Doha Development Agenda, will also have a major impact on export diversification initiatives in the island subregion. Given their special circumstances, greater flexibility in the application of trade rules to these small island economies may be desirable.

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