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

Note by the secretariat

Summary

The V-shaped recovery from the depths of the 2008-09 global financial crisis in 2010 proved to be short-lived as the world economy entered a second stage of the crisis in 2011 with a sharp deterioration in the global environment involving an accentuation of the euro zone debt crisis and a continued uncertain economic outlook for the economy of the United States of America. As forewarned by the *Economic and Social Survey of Asia and the Pacific 2011*, the growth rate of Asia-Pacific developing economies declined substantially in 2011, and a further slowdown was forecast for 2012, emanating from slackening demand for the region's exports in advanced economies and higher costs of capital. As the region struggles to emerge from the crisis, the serious and growing inequalities between and within countries of the region are a cause of even greater concern. Despite the slowdown, Asia and the Pacific will remain the fastest growing region globally and an anchor of stability in the world economy. Many economies in the region continue to grapple with the challenge of inflation. With inflation remaining relatively high in some countries due to domestic factors and in view of concerns about global commodity prices, the dilemma of maintaining price stability in the face of slackening growth resulting from the deteriorating global environment has not fully receded. Further injection of liquidity into the financial markets will heighten the risk of asset market bubbles and exchange rate appreciation. An increasing concern for policymakers in the region is the imposition of various trade-restrictive measures by crisis-affected countries. A number of countries in the region have also been severely impacted by the effects of natural disasters, which have significant regional implications. Despite the challenging global environment, the region remains in a relatively favourable situation in terms of protecting its economic dynamism due to its strong macroeconomic fundamentals. If serious pressure on growth performance were to materialize, many countries would benefit from sufficient policy space to undertake supportive measures. The present document summarizes the analysis of the *Economic and Social Survey of Asia and the Pacific 2012* with regard to the current global turbulence and the region's outlook for the year ahead. In addition, this year the *Survey* conducts an in-depth analysis of the long-term policy implications of high commodity prices.

The Commission may wish to deliberate on these issues and make policy recommendations for promoting inclusive and sustainable development in the region.

* The late submission of the present document is due to the non-availability of 2011 data by the deadline for submission of documents to conference services.

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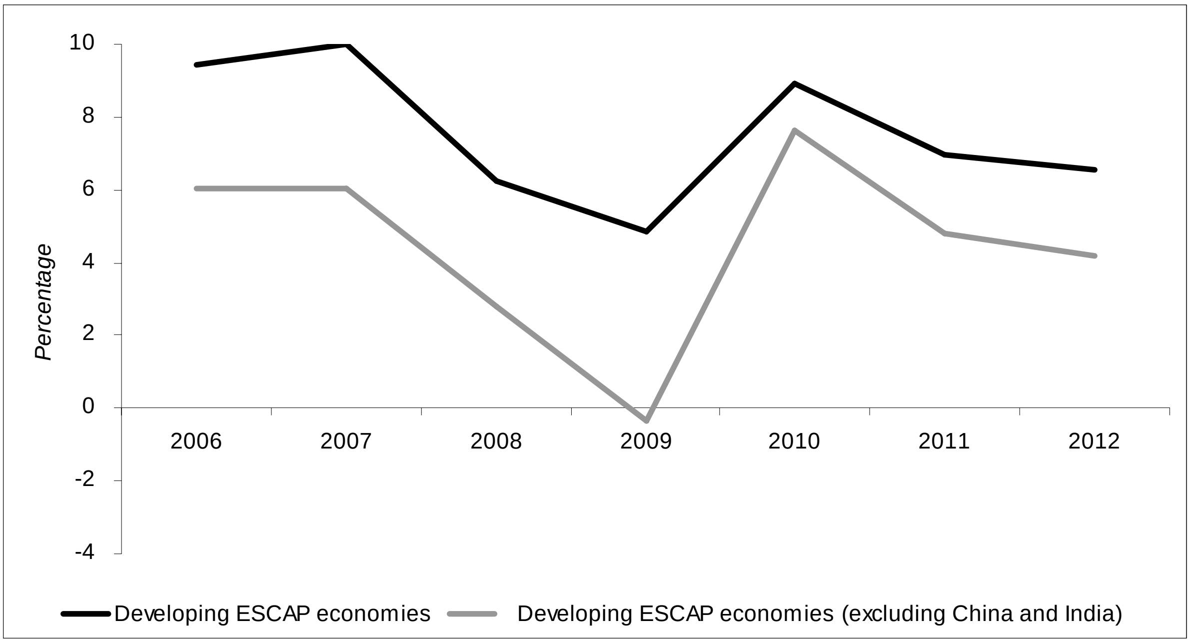
I. Growth outlook for 2012

A. Second stage of the crisis

1. The V-shaped recovery in 2010 from the depths of the 2008-09 global financial crisis proved to be short-lived as the world economy entered a second stage of the crisis in 2011 with a sharp deterioration in the global environment with an accentuation of the euro zone debt crisis and a continued uncertain economic outlook for the economy of the United States of America. As forewarned by the *Economic and Social Survey of Asia and*

the Pacific 2011,[1] the growth rate of Asia-Pacific developing economies declined to 7.0 per cent in 2011 from a robust rate of 8.9 per cent achieved in 2010 (see figure 1). The growth rate of the economies of the region is forecast to decline further, to 6.5 per cent, in 2012 with slackening demand for the region's exports in advanced economies and as a result of higher costs of capital.

Figure 1
Economic growth rates for Asia-Pacific developing economies, 2006-2012



Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs, World Economic Situation and Prospects 2012 (United Nations publication, Sales No. E.12.II.C.2), available from www.un.org/en/development/desa/policy/wesp/wesp_current/2012wesp.pdf; International Monetary Fund, International Financial Statistics databases (Washington, D.C., January 2012); Asian Development Bank, Key Indicators for Asia and the Pacific 2011 (Manila, 2011); CEIC Data Company Ltd. (http://ceicdata.com); and website of the Interstate Statistical Committee of the Commonwealth of Independent States (www.cisstat.com/eng), March 2012.

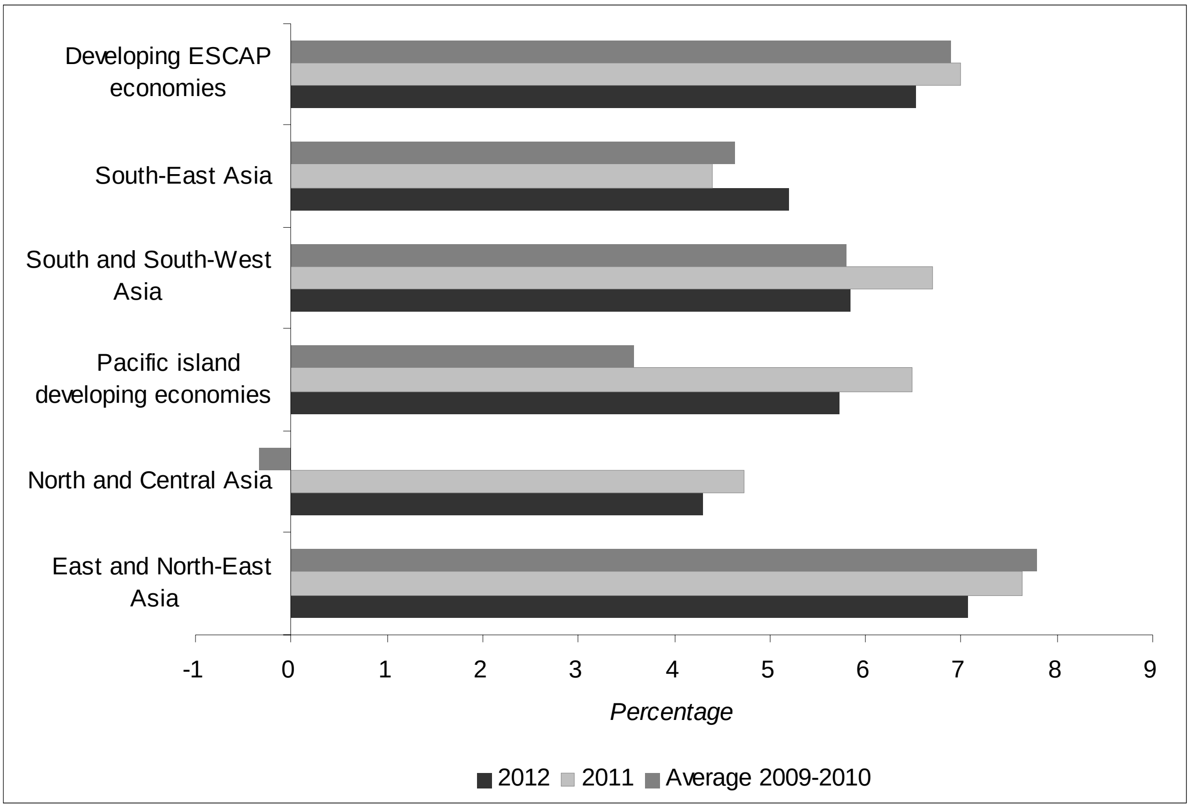
Notes: Rates of real gross domestic product (GDP) growth for 2011 are estimates, and those for 2012 are forecasts (as of 19 April 2012). Asian and Pacific developing economies comprise 37 economies (excluding those in North and Central Asia). The calculations are based on the weighted average of GDP figures in dollars in 2010 (at 2000 prices).

2. The growth slowdown will be felt across different subregions depending upon the extent of their global integration. The growth rate in East and North-East Asia is forecast to slow to 7.1 per cent in 2012 (from 7.6 per cent) (see figure 2). North and Central Asia is forecast to experience a relatively moderate slowdown, to 4.3 per cent, in 2012, benefiting from the high price of energy. The Pacific island developing economies are forecast to experience lower aggregate growth in 2012 of 5.7 per cent, due mainly to lower growth in Papua New Guinea, although a number of other countries are likely to maintain fairly stable performance. The South and South-West Asian subregion is forecast to see a slowdown to 5.9 per cent in 2012 from 6.7 per cent in 2011, although this will be due more to monetary tightening than the global slowdown. Although South-East Asia is an open subregion with many economies which are impacted severely by the state of the global economy, it is forecast to see a slight increase in growth as a

[1] United Nations publication, Sales No. E.11.II.F.2.

whole, to 6.5 per cent, in 2012, due to a strong recovery of growth in Thailand following the floods of 2011. With the growth slowdown, inflation is forecast to moderate from 6.0 per cent in 2011 to 4.8 per cent in 2012 (see figure 3).

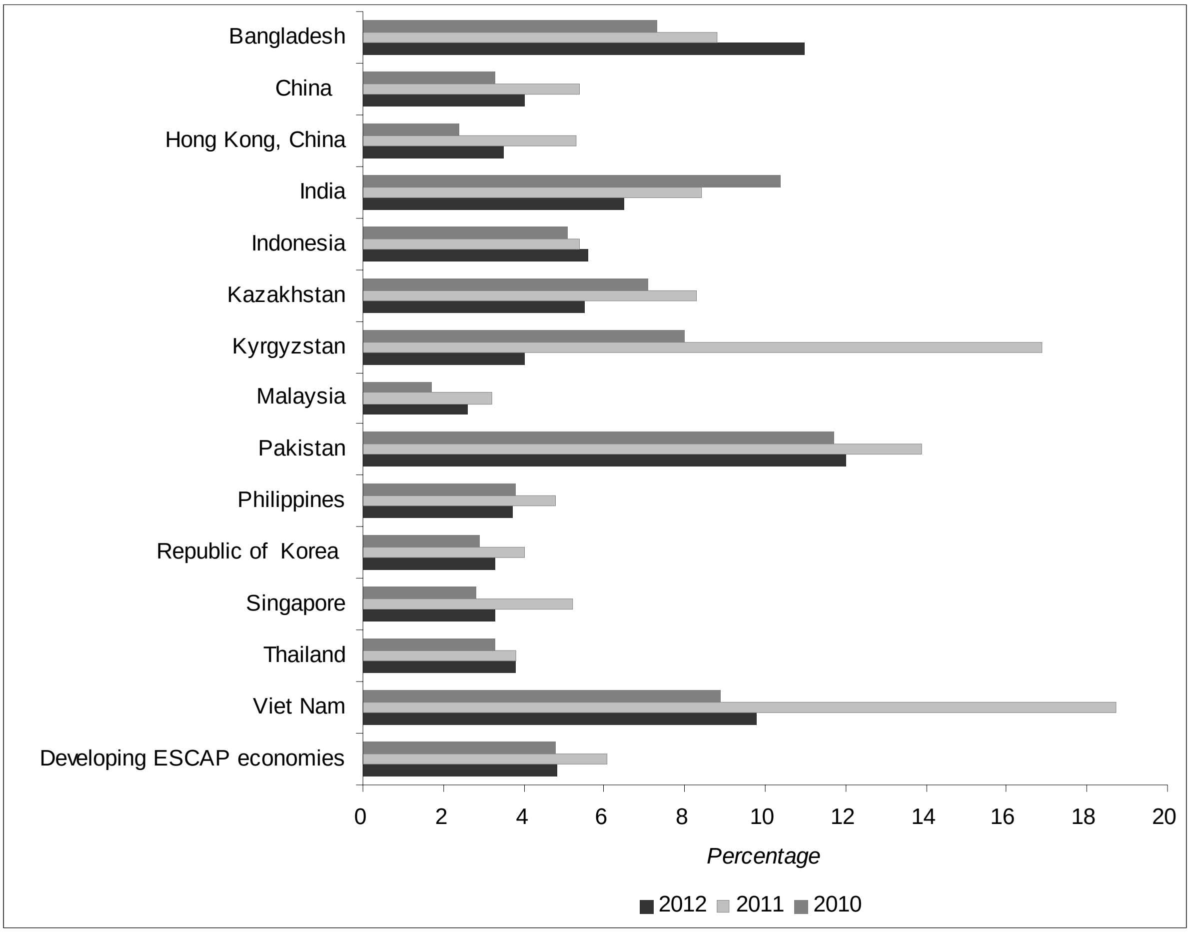
Figure 2
Real GDP growth and forecasts of Asia-Pacific developing economies by subregion, 2009-2011



Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs, *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2), available from www.un.org/en/development/desa/policy/wesp/wesp_current/2012wesp.pdf; International Monetary Fund, International Financial Statistics databases (Washington, D.C., January 2012); Asian Development Bank, *Key Indicators for Asia and the Pacific 2011* (Manila, 2011); CEIC Data Company Ltd. (http://ceicdata.com); and website of the Interstate Statistical Committee of the Commonwealth of Independent States (www.cisstat.com/eng), March 2012.

Notes: Rates of real gross domestic product (GDP) growth for 2011 are estimates; those for 2012 are forecasts (as of 19 April 2012). "Developing ESCAP economies" comprises 37 economies (excluding those in North and Central Asia). "East and North-East Asia" in this figure excludes Japan. The calculations are based on the weighted average of GDP figures in dollars in 2010 (at 2000 prices).

Figure 3
Consumer price inflation in selected developing economies of the ESCAP region, 2010-2012



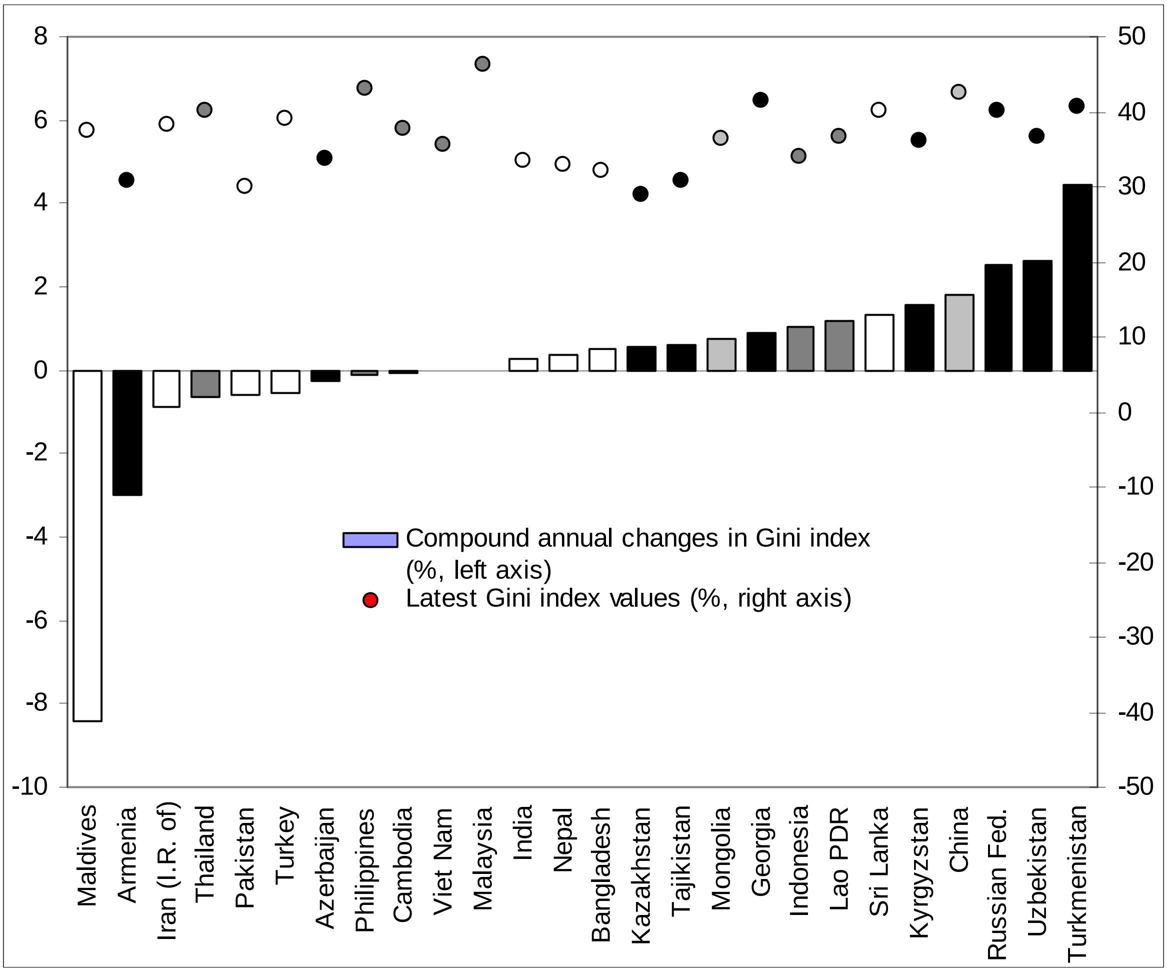
Sources: ESCAP, based on national sources; United Nations, Department of Economic and Social Affairs, *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2), available from www.un.org/en/development/desa/policy/wesp/wesp_current/2012wesp.pdf; International Monetary Fund, International Financial Statistics databases (Washington, D.C., January 2012); Asian Development Bank, *Key Indicators for Asia and the Pacific 2011* (Manila, 2011); CEIC Data Company Ltd. (http://ceicdata.com); and website of the Interstate Statistical Committee of the Commonwealth of Independent States (www.cisstat.com/eng), March 2012.

Notes: Rates of inflation for 2011 are estimates; those for 2012 are forecasts (as of 19 April 2012). ”Developing ESCAP economies” comprise 37 economies (excluding those in North and Central Asia). The calculations are based on the weighted average of gross domestic product figures in dollars in 2010 (at 2000 prices).

3. As the region continues to be impacted by the crisis, the serious and growing inequalities between and within countries of the region, both in terms of income and social progress, are a cause of even greater concern. Income inequality in developing Asia-Pacific countries has been rising at a worrying pace, increasing by 15 per cent between the 1990s and 2010. During this period, income inequality rose in 16 out of 26 countries for which data are available, including the major economies of the region, such as China, India, Indonesia and the Russian Federation, and by up to 4.4 per cent per annum in the most serious cases (see figure 4). Social progress in the region has been significantly constrained by the evident levels of inequality. Achievement of the health-related and educational aspects of human development, when adjusted for inequality, is considerably lower for many countries in the region, ranging from a loss in achievement of 10 per cent to 30 per cent. It is clear from these worrying trends that the growth

model in the region has to be rebalanced through policies that propagate prosperity by empowering those who have been left behind.

Figure 4
Changes in Gini coefficients and latest value for selected developing Asia-Pacific countries, 1990s-2010



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

Note: Subregions are differentiated by colour: black for North and Central Asia, dark grey for South-East Asia, light grey for East and North-East Asia, and white for South and South-West Asia

4. Despite the slowdown, the region will remain the fastest growing globally and an anchor of stability in the world economy. The region's growth engines continue to grow at robust rates. China is likely to grow at 8.6 per cent in 2011 after decelerating from the 9.2 per cent achieved in 2011. India, on the other hand, is expected to improve its growth performance from 6.9 per cent to 7.5 per cent in 2012 as moderating inflation would allow an unwinding of the cycle of monetary tightening during the current year, thus unleashing growth impulses. With its continued dynamism, the Asia-Pacific region has begun to act as a growth pole for other developing regions, namely Latin America and Africa, helping them to reduce their dependence on low-growth developed economies as South-South trade becomes an important trend.

B. Downside risks

5. The above projections are subject to some significant downside risks, foremost among them being a disorderly sovereign debt default in

Europe or the break-up of the euro common currency area, which could lead to a renewed global financial crisis. ESCAP estimates that such a crisis could, in a worst case scenario, lead to a total export loss of $390 billion over 2012-13. The countries that would suffer most would be those with special needs, such as least developed and landlocked developing countries, which depend heavily on advanced country markets and could see exports contract by 10 per cent. The loss of exports could lead to a reduction in growth of up to 1.3 percentage points in 2012 and hamper poverty reduction in the Asia-Pacific region to such an extent that, by 2013, an additional 14 million people could be trapped below the $1.25-a-day poverty line and 22 million below the $2-a-day poverty line.

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

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

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

9. The blow of lower exports to developed countries could also be cushioned by greater intraregional trade. This is already growing more rapidly than trade with the rest of the world: between 2000 and 2010, intraregional exports increased from 43 per cent to 50 per cent of total exports. However, a significant portion of these exports comprises intermediate goods or commodities which principally go to China. It should

be noted that, in comparison with advanced countries, the import content of consumption in China is quite low. For the region's exporters of manufactured goods, India and Indonesia offer increasingly promising markets, although, at present, their consumers have less purchasing power than those in China. Similarly, intraregional flows have helped foreign direct investment inflows recover in view of the growing importance of Asia-Pacific economies as sources of such investment.

II. Policy challenges and options

A. Managing the growth and inflation balance

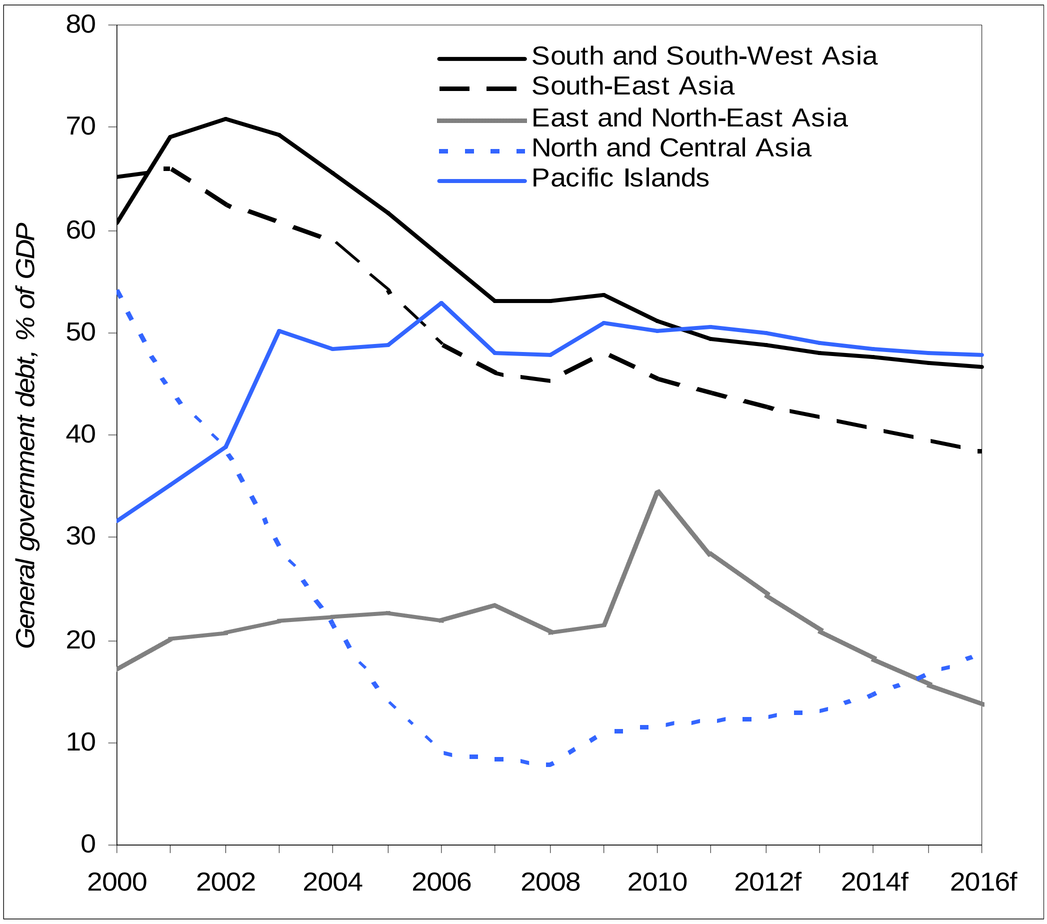
10. Growth in many countries in the region will come under pressure in the difficult global climate. With relatively sound macroeconomic fundamentals and low public debt to gross domestic product (GDP) ratios, Asia-Pacific developing economies have considerable policy space to mount fiscal stimulus programmes and relax monetary policy to support growth. Relative to other regions, public indebtedness in Asia and the Pacific is not generally high. Indeed, between 2001 and 2008, government debt-to-GDP ratios fell from 53 per cent to 34 per cent (see figure 5), and despite fiscal stimulus during the turmoil of 2008-09, the ratio over the period 2009 to 2011 was still only 38 per cent. Most economies therefore have significant fiscal space. Some economies in the region have already announced fiscal stimulus programmes in the second half of 2011 in response to deteriorating economic situation, such as Malaysia and the Philippines. They also have the space to lower policy rates with a view to relaxing monetary policy in order to provide economic stimulus. Indonesia and Thailand, for example, lowered interest rates in the last quarter of 2011.

11. The concern with enacting stimulus measures in the region is their impact on inflation. If inflation remains high despite slowing growth because of external factors, then further stimulus would support growth at the cost of increasing inflation to uncomfortable levels. However, monetary policy to manage inflation is a blunt instrument as it implies controlling external or supply-led price increases by restricting local demand. Governments will therefore need other inflation-fighting measures, such as reducing taxes or tariffs along with restricting inflows of foreign capital. Nevertheless, in cases of substantial price increases, monetary policy may remain the most effective tool, albeit with significant implications for growth. Policymakers thus need to find their preferred inflation-growth combination, as there is clearly a trade-off between tackling the former and fostering the latter.

B. Coping with capital flows

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

Figure 5
Public debt of ESCAP subregions



Source: ESCAP calculations and International Monetary Fund World Economic Outlook Database.

Note: The regional debt ratios are weighted means, based on a country's gross domestic product in corresponding years.

13. Economies in Asia and the Pacific have traditionally managed exchange-rate volatility by accumulating foreign exchange reserves, but these reserves are not necessarily adequate. Some countries have acknowledged this by arranging other sources of foreign exchange support, while also looking to global financial safety net arrangements through the International Monetary Fund, regional agreements, such as the Chiang Mai Initiative, and bilateral currency swap arrangements, such as the one signed by India and Japan in December 2011 for $15 billion.[2]

14. In addition, given the disadvantages of dealing with capital flows by using reserves, economies in the region have increasingly turned to capital account management measures. Indonesia, the Republic of Korea and Thailand imposed such measures in 2010. However, the continuing surge of volatile short-term capital to the region has made it necessary to consider further measures, such as applying quantitative restrictions on short-term equity flows and non-productive investment lending by banks in order to improve the quality of capital flows. ESCAP analysis shows that overall

[2] Times of India, "India, Japan agree to $15 billion currency swap" (available from http://timesofindia.indiatimes.com/business/india-business/India-Japan-agree-to-15-billion-currency-swap/articleshow/11295378.cms).

stringency of measures may help prevent extraordinarily high surges in inflows, although it highlights the need to tailor the instruments to the types of flows by which the country is affected. It is clear that Asia-Pacific economies may have to design capital account management measures to deal with the "new normal" of pressure for the entry of volatile short-term capital into the region.

C. Addressing unemployment

15. The unemployment rate in Asia and the Pacific has fallen only slightly, from 4.3 per cent in 2010 to 4.2 per cent in 2011. The region continues to face the problem of jobless growth, with the Asian developing countries failing to generate sufficient opportunities in the formal sector. The problems are greatest for young people, who are three times more likely to be unemployed than adults. The youth unemployment rate for the Asia-Pacific region is projected to remain at 10.2 per cent in 2012. Moreover, in 2010, some 1.1 billion workers in the region remained in vulnerable employment.

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

D. Dealing with disaster risks

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

18. Overall, damage and losses in the Asia-Pacific region during 2011 were at least $267 billion.[3] Critically, the impact of disasters can be felt throughout the region in view of the growing interdependence of countries in the region. For instance, the earthquake in Japan and the floods in Thailand caused severe disruptions in regional and global supply chains, particularly for industrial products and manufacturing. Moreover, severe floods in the Asia-Pacific region resulted in production losses in the agricultural sector, which had an impact on food production regionally and globally.

[3] ESCAP calculations based on data from EM-DAT International Disaster Database (www.emdat.be), Centre for Research on the Epidemiology of Disasters, Brussels.

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

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

E. The rebalancing challenge

21. The continued uncertain economic outlook for developed economies coupled with the imperative of restraining debt-fuelled consumption as a part of unwinding global imbalances means that a return to pre-crisis business as usual, whereby developed countries acted as growth engines for Asia-Pacific developing countries, would be highly unlikely. The Asia-Pacific region will have to gradually rebalance its economies in favour of domestic consumption and investment and of deepening regional economic integration. An acceptable range of policies to continue the rebalancing of economies at a time of constrained growth is to implement a set of measures that supports future growth engines without unduly impacting those of the present. These measures should include greater investment in infrastructure which could be supported by a new regional financial architecture for development financing. Consumption by individual families could also be increased if they had less need for precautionary savings because governments were providing greater security through stronger systems of social protection. These would include strengthening systems for pensions, health and unemployment insurance, for example, and spending more on health and education services. Another set of policies should be directed towards agriculture – to boost incomes in the rural areas that are home to the majority of the region’s poor families. Many countries would benefit from a knowledge-intensive second “green revolution” based on sustainable agriculture.

22. A third set of policies would be to support the development of the “green economy”, which recognizes the important interlinkages between the environmental resource base, economic systems and social development and which focuses on the building blocks of sustainable development – from food and nutritional security to sustainable energy and universal access to safe drinking water and sanitation for all. To provide sufficient resources, a mix of public and private finance is needed. At the international level, measures to scale up financing for sustainable development should facilitate free or low-cost access to technology. These issues will receive particular attention in 2012 at the United Nations Conference on

Sustainable Development, to be held in Brazil. Green economy policies are tools that can help develop these synergies between economic growth and environmental sustainability.

23. Finally, an important key to rebalancing in the Asia-Pacific region is to exploit the potential of regional economic integration. While intraregional trade has expanded rapidly since 1998, reaching 54 per cent in 2008, the potential is even greater. The existing approaches towards exploiting the potential of intraregional trade in Asia and the Pacific have been primarily limited to numerous subregional and bilateral preferential trading arrangements. Owing to differences in rules, scope and coverage, these preferential arrangements do not provide a broader, seamless Asia-Pacific market. A broader pan-Asian integrated market might help in exploiting the complementarities between the subregions which ESCAP analysis has demonstrated to be substantial and often greater than those within the subregions. The agenda for exploiting regional economic integration also needs to pay attention to strengthening physical connectivity and people-to-people contacts by addressing critical gaps in hard and soft infrastructure, as highlighted by ESCAP.[4] The sixty-eighth session of the Commission would offer an opportunity to provide an impetus to the agenda of regional economic integration in Asia and the Pacific.

F. Development-friendly global economic governance

24. The Asia-Pacific region has a stake in the way the global economy is managed and governed, keeping in mind the fact that the growth outlook of the region is so critically affected by the global economic environment, as shown in section I.A. The Asia-Pacific region should use its collective weight in global forums, such as the G-20 summits, in which eight countries of the region are represented, or the BRICS summits, in which three countries of the region are involved. First and foremost, the Asia-Pacific region must draw the attention of the international community to the need for reforms aimed at reviving growth and creating jobs in advanced countries. This should involve a credible medium-term programme of fiscal consolidation and the use of responsible macroeconomic policies to avoid excessive liquidity creation that leads to volatility in the emerging markets. Instead of volatile short-term capital, Asia-Pacific developing economies need a flow of long-term development finance for financing their widening deficits in infrastructure development. They should also seek a cease and desist moratorium on protectionist tendencies in developed countries.

25. Asia-Pacific members of the G-20 should also advocate for the Group to play a role as a premier council for global economic cooperation to moderate the volatility of oil and food prices, which are highly disruptive to the process of development. As regards oil price volatility, all major consumers are members of the G-20, thus giving the Group the power to match that which is exercised over the oil markets by the cartel of producers, the Organization of the Petroleum Exporting Countries (OPEC). ESCAP has proposed that OPEC and the G-20 demarcate a benchmark “fair” price of oil and agree to restrict the oil price movement within a band

[4] *Economic and Social Survey of Asia and the Pacific 2011: Sustaining Dynamism and Inclusive Development: Connectivity in the Region and Productive Capacity in Least Developed Countries* (United Nations publication, Sales No. E.11.II.F.2), Chap. 3.

around it.[5] An additional measure to moderate volatility in oil markets is for the G-20 to create a global strategic reserve and release it countercyclically. Experience has shown that oil prices go down when major developed economies draw on their strategic reserves. In the case of food price volatility, the G-20 could act to regulate speculative activity in food commodities and discipline the conversion of cereals into biofuels. It may expedite the implementation of the L'Aquila Food Security Initiative,[6] which included the provision of financing for developing countries.

26. The region will also need to exert influence in favour of building a more development-friendly international financial architecture emerging through discussions in the G-20. Important proposals outlined by ESCAP in this regard include: (a) establishing a global reserve currency, based on special drawing rights, that could be issued countercyclically; (b) a global tax on financial transactions to raise resources for achieving the Millennium Development Goals apart from moderating short-term capital flows; and (c) international regulations to curb excessive risk-taking by the financial sector. The approach adopted by the G-20 to address global imbalances by restraining current account imbalances to a certain percentage of GDP is a good start. In these and other areas, the Asia-Pacific region can further coordinate its actions — through its eight members in the G-20 — to ensure that the global economic governance architecture meets the region's developmental needs. The United Nations should play a leading role in facilitating broad-based consultations on global issues, given its global membership, including providing an outlet for non-G-20 countries to communicate their views to the summits, as ESCAP has done through its ongoing programme of high-level consultations on perspectives from Asia and the Pacific for the G-20 summits.

III. Living with high commodity prices

27. Commodity price volatility has raised global concerns about inflation, hunger and poverty, but longer-term rises in commodity prices also threaten the growth trajectory of developing countries and could widen global disparities. Breaking the historical downward trend in prices, commodity markets have been experiencing a boom since 2000 (see figure 6), with average annual price growth rates ranging from 1.8 per cent for beverages to 17.4 per cent for metals and minerals.[7]

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

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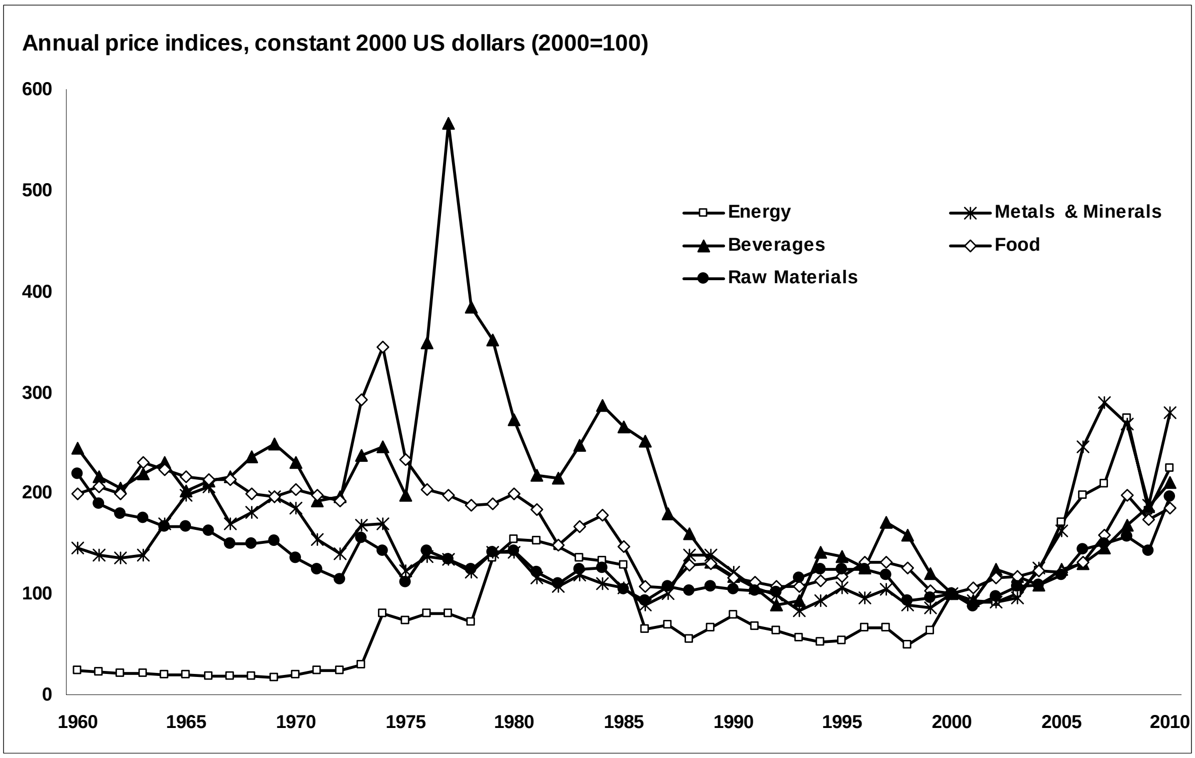
5 Ibid., Chap. 1, p. 46.

6 See L'Aquila Joint Statement on Global Food Security (available from www.g8italia2009.it/static/G8_Allegato/LAquila_Joint_Statement_on_Global_Food_Security%5B1%5D%2c0.pdf).

7 ESCAP based on data from World Bank, World Development Indicators, available from http://data.worldbank.org/data-catalog/world-development-indicators (accessed 27 September 2011).

Figure 6
The new century was a turning point for commodity prices



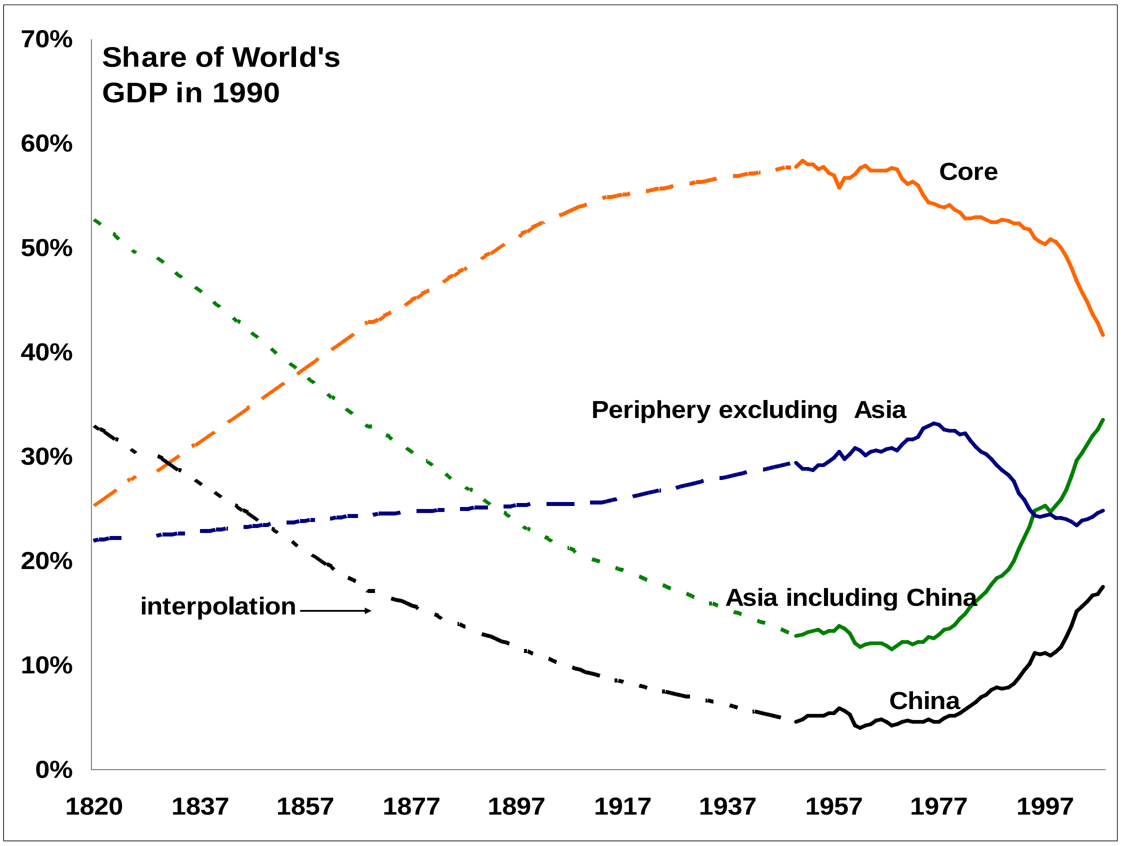
Source: ESCAP based on data from World Bank, World Development Indicators, available from http://data.worldbank.org/data-catalog/world-development-indicators (accessed 5 April 2012).

29. In the nineteenth century, there was a similar situation. The industrial revolution increased demand for fuel, fibre and metals, causing the prices of primary products to soar.[8] In the late 1970s, a group of countries, this time from Asia, started to become major global players, echoing what had occurred 150 years earlier. Between 1979 and 2008, these countries increased their share of global GDP from 13 per cent to 33 per cent (see figure 7). The two principal growth engines over this period were China, whose share in global GDP increased from 5 per cent to 17 per cent, and India, whose share increased from 3 per cent to 7 per cent. Their rapid growth drew in other Asian countries that were part of the supply chains of manufacturing production.

30. The boom in commodities has ended a secular decline in commodity terms of trade. Exporters of commodity are enjoying improvements in their terms of trade while many low-income resource-scarce countries have endured the increase in price of imports and reduction of international price of their manufacturing exports resulting in diminishing terms of trade. The countries that experienced the highest increase in their terms of trade during the period 2000 to 2008 were all major exporters of energy resources or minerals. On the other hand, countries whose main exports are manufactures have seen their terms of trade deteriorate.

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

Figure 7
The rise of Asia, share of global GDP



Source: ESCAP based on data from Angus Maddison, Historical Statistics of the World Economy: 1-2008 AD, University of Groningen, Netherlands, 2009 (available from www.ggdc.net/MADDISON/oriindex.htm, accessed September 2011).

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

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

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

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

34. In addition, all countries face the risk that high food prices will affect their most vulnerable people the most, increasing hunger and poverty and bringing economic and social impacts that are severe and long-lasting.

A. The need for continuing manufacturing-led growth

35. For the Asia-Pacific developing economies, the major obstacle to manufacturing-led growth may not be slower global demand. As indicated in figure 8, the long-term series show that, even before the 2008 economic crisis raised doubts about the sustainability of export-led growth, global demand was shifting towards the emerging and developing economies. Emerging economies have been increasing their share of global imports consistently since the early 1990s. In the past decade, this share has increased by more than half, from an average of 22 per cent in 2000 to 36 per cent in 2010. China has made the largest contribution in the last decade, tripling its share of global imports to 9 per cent in 2010. On the other hand, the share of global imports of the advanced economies declined from 78 per cent in 2000 to 63 per cent in 2010. The main source of the decline has been the United States, which between 2000 and 2010 reduced its share of global imports from 18 to 12 per cent. After 2009, the share of global imports of the European Union also reduced, dropping by three percentage points.

36. The growing importance of emerging economies as the destination for global exports is expected to continue in the near future. By 2020, Asia will have more than half the world's middle class, who will account for over 40 per cent of global middle-class consumption.[9]

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

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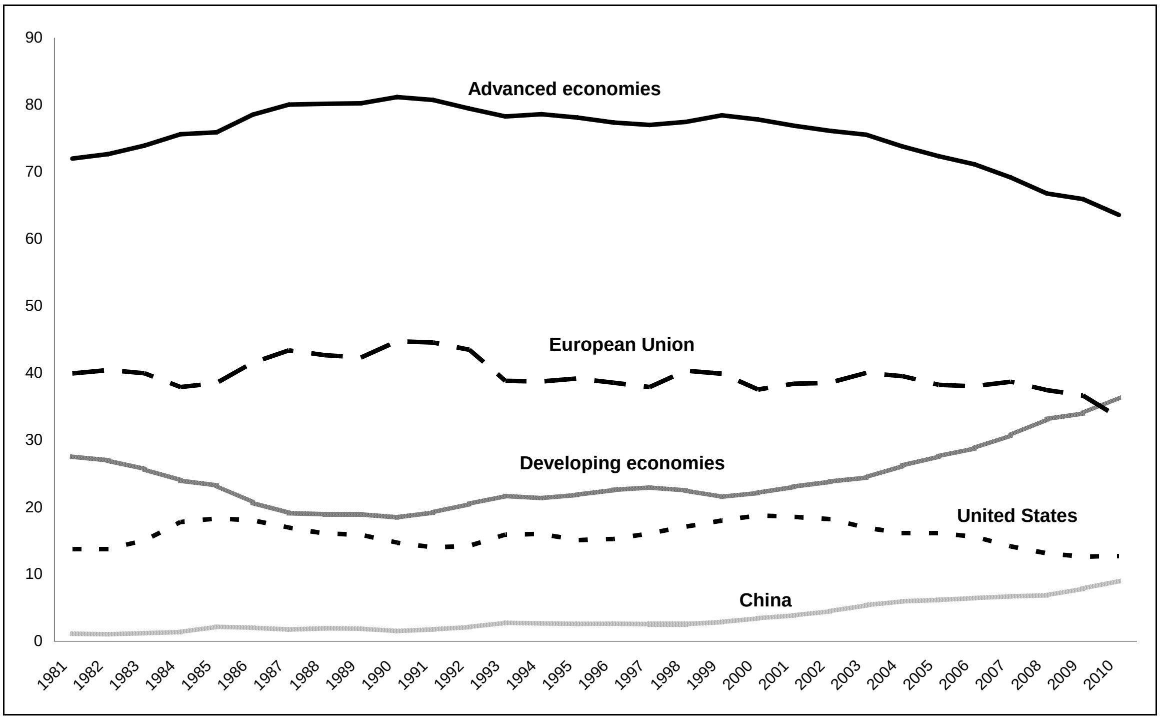
[9] Homi Kharas, "The emerging middle class in developing countries", OECD Development Centre, Working Paper No. 285 (Paris, OECD, 2010). Available from www.oecd.org/dataoecd/12/52/44457738.pdf.

Figure 8
Share in global imports
(*Percentage*)



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

38. This represents a shift in attitude. Previously, the incumbent countries largely ignored the non-orthodox economic policies of the catching-up countries, including industrial policy, infant-industry protection, export subsidies, trade protection and exchange-rate undervaluation (all of which had been, and still are, implemented by the now developed economies).[10] The implementation of these policies has become more subtle with the establishment of the World Trade Organization (WTO), but they have not disappeared. Currently, the incumbent countries are paying more attention to developing countries as prospective competitors. The smaller catching-up economies may still be able to adopt these policies unopposed but the larger ones would find difficulty doing this.

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

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

B. Avoiding the natural resources curse

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

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

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

43. Commodity boomers also face the risk that volatile commodity prices can destabilize their economies. They should therefore use resource flows efficiently and smooth the ups and downs in revenue. One way to achieve this would be to channel the resource windfall away from immediate consumption and into productive investment abroad through sovereign wealth funds. These would enable current generations to pass on the equivalent value of the natural assets. For example, three decades ago, some of the Arab States had oil and little else. As a result, they decided to create a fund so that future generations would, instead of oil, have the wealth created by a diversified economy.[11]

C. The need for balanced economic integration

44. Low-income countries with few natural resources but abundant labour have the potential to exploit the opportunities of free trade to climb the development ladder through labour-intensive manufacturing. This was the growth story of Japan during the nineteenth century. When Japan opened to free trade in 1858, it used its comparative advantage of cheap labour for silk and textile manufacturing to drive industrialization.

[11] Paul Collier, *The Plundered Planet: How to Reconcile Prosperity with Nature* (London, Penguin Books, 2011), pp. 9, 32.

Consequently, its terms of trade increased as the prices of its labour-intensive exports rose to international levels and the price of land- and capital-intensive imports fell to world market levels.[12] The same happened subsequently with other Asia-Pacific labour-abundant countries that opened to trade. The Bangladesh garment industry that developed in the 1980s is another example.

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

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

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

D. Coping with high food prices

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

49. More importantly, food price rises hurt the poor, who are net buyers of food, and leave them less income to spend on other priorities, including health and education. Although the impact may vary by household,

[12] Jeffrey G. Williamson, *Trade and Poverty: When the Third World Fell Behind* (Cambridge, Mass., MIT Press, 2011), pp. 71-72.

commodity and country, high prices are more likely to increase poverty than reduce it.[13]

50. To avoid this, several countries have addressed rising prices through food-based safety net programmes. Afghanistan, for example, has a food support programme targeted at vulnerable populations. Armenia has a targeted family benefit programme. Georgia has a targeted social assistance programme and untargeted food coupons. India released buffer stocks of wheat and rice and distributed wheat and rice to targeted poor families. Uzbekistan has introduced targeted food benefits and child and maternity nutrition programmes. Mongolia has issued targeted food stamps. Indonesia offered a subsidized programme of rice for the poor. And the Philippines has a rice subsidy programme.[14]

51. For social protection, many developing countries in Asia and the Pacific have a way to go: only 20 per cent of the population have access to health-care assistance; only 30 per cent of the elderly receive pensions; and only 20 per cent of the unemployed and underemployed have access to labour market programmes, such as unemployment benefits, training, or public works programmes, including food for work.[15]

52. The best way to reduce food prices in the long term is to increase agricultural productivity. The main drivers of increased agricultural productivity are new and improved technologies. Cultivation practices, such as no-till farming, which involves injecting seeds directly into the soil instead of sowing on ploughed fields, combined with residue management and proper fertilizer use, can help preserve soil moisture, maximize water infiltration, increase carbon storage, minimize nutrient runoff and raise yields. Fertilizer use can also be reduced by taking greater advantage of organic sources of nutrients, including animal manure, crop residues and nitrogen-fixing legumes.

53. Another powerful tool for boosting the productivity of crops, livestock, fisheries and forests is biotechnology. Though the general public usually associates agricultural biotechnology with genetic modification, there are many other useful forms, including genomics and bioinformatics, marker-assisted selection, diagnostic procedures, micropropagation, tissue culture, cloning, artificial insemination and embryo transfer.[16]

54. In addition, mobile phones are helping small farmers obtain information about crop prices and related information. Raising agricultural productivity will also depend on better irrigation and water management. Major priorities include: stepping up public investment, pricing irrigation

[13] Maros Ivanic and Will Martin, “Implications of higher global food prices for poverty in low-income countries”, Policy Research Working Paper No. 4594 (WPS4594) (Washington, D.C., World Bank 2008). Available from www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/04/16/000158349_20080416103709/Rendered/PDF/wps4594.pdf.

[14] Asian Development Bank, *Global Food Price Inflation and Developing Asia* (Manila, 2011). Available from www.adb.org/sites/default/files/pub/2011/food-price-inflation.pdf.

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

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

water and electricity more rationally, and using groundwater resources more equitably and profitably.

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

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