

# **The Poor in East and South East Asia in the time of Financial Crisis**

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## Table of Contents

### **I. Structural reasons why vulnerabilities of poor should be a cause of concern to governments**

*Significant proportion of the East Asian population is still poor*

*Share of workforce in the informal economy is very large in most countries*

*Share of workforce in agriculture is still very large, yet agriculture neglected*

*Food self-sufficiency ratio declining, while import prices have been rising*

*Share of exports in GDP is far higher than in comparator countries*

### **II. Why East Asian countries are less vulnerable now compared to post-1997?**

### **III. Why economic growth might be slower in East Asian economies in the long run?**

### **IV. Case Studies – Cambodia and Indonesia**

### **V. Addressing vulnerabilities among the poor in East Asian economies**

*Initiate social insurance mechanisms for families in the informal economy*

*Initiate social assistance programmes for families in the informal economy*

*Needed a fiscal package to stimulate demand and offset falling employment in exportables*

*Focus on agriculture*

**List of tables and graphs**

Table 1: Percentage of population below the poverty line

Table 2: Gini coefficient, 1990-2002

Table 3: Share of informal employment in Indonesia, Thailand and the Philippines

Table 4: Sectoral share of GDP of Agriculture, Industry and Services, 2000-2005

Table 5: Share of expenditure on food of poorest 30% of households

Table 6: Exports to GDP ratio, 1990-2005

Table 7: Rate of Economic Growth, 1996-2005

Table 8: Government budget deficit as a percent of GDP, 1997-2005

Table 9: Current account balance as a percent of GDP, 1997-2006

Table 10: Foreign exchange rates, 1997-2007

Table 11: Foreign direct investment flows into ASEAN countries, 1995-2006

Table 12: Unemployment rates, 1996-2006

Table 13: Inflation rates, 1997-2007

Table 14: Interest rates, 1997-2005

If we wish to learn about how the quality of life and the state of well-being of the lowest five deciles of the citizens of a nation we have to examine the diverse sources of income and livelihood that these citizens utilize to make a living. However, the difficulty with using these diverse forms as points of reference is that data is rarely collected based on these sources, and even if it was, it never is collected at any degree of frequency to enable us – the ones who belong to the policy-making or policy-influencing community whose decisions impact, either positively or negatively, the well-being of the poor – to make a determination on what is happening over time to the quality of life. Policy-makers normally show a particular concern for the poor in situations when exogenous shocks might negatively affect livelihoods of the poor which may vicariously impact the status quo of the social and political situation.

People everywhere receive several forms of income, and the composition of the total varies according to a person's social and work status, and takes into account the degree of a person's socio-economic security (Standing et al, 2008). *We will not consider separately the security of children here separately from that of their families, since the vast majority of children live with their families in households.* The total will be called the person's total *income*. The individual's total income, is *value of self-production* (whether self-consumed, bartered or sold), plus the *money wage received from work*, plus the value of benefits or support provided by the *family, kin or the local community*, plus the amount of *benefits provided by the enterprise* in which the person might be working, plus the value of *state benefits*, in terms of insurance benefits or other transfers, and *private income benefits*, gained through investment, including private social protection.

If we are truly interested in determining the impact, positive or negative, of the exogenous shock that US-driven financial meltdown on the total income of a person in East Asia, it would be impossible to do so for the following reasons: one, usually there is no information on value of self-production (or requires a special survey to identify the value), or value of benefits received from kin or community, and two, the value of private income benefits people are unwilling to reveal especially if they are currently outside the direct tax net (which a high proportion of the poor and even non-poor are likely to be since they work in the informal sector of the economy).

The value of state benefits can be known, but in East Asia there is hardly any country that provides state benefits of any serious magnitude to the poor who toil in the informal sector without much social security. Social protection or security is confined to the minority of the work force that belongs to the formal, organized enterprises, either in the private or public sectors. Similarly, wages received from work can be estimated and are usually available for those who form in the formal sector, but not for those in the informal sector, who by and large constitute the majority of the work force in most low-

income and low-middle income countries of East Asia, especially the ASEAN countries, which are the focus of this analysis.<sup>1</sup>

In the absence of such critical data, there is no alternative to adopting proxies for determining the impact of exogenous shocks (like the global financial meltdown of late 2008) on the livelihoods and well-being of citizens, especially the poor. We will, therefore, use such proxies as gross domestic product; exports, since these are highly export-dependent economies, and especially export sectors in which the poor might be employed directly or indirectly through the backward and forward linkages to determine impacts; agriculture, which again is a high employer of many of these low- and low-middle income economies. We will also examine the status of employment in the informal sector, which accounts for a significant share of total employment outside of agriculture, and in which vulnerabilities of the poor are very high. We will also see to what extent those outside the formal sector have access to state benefits in the sense of social insurance or transfers (other than health and education benefits that are normally reasonably well-provided at least in the middle-income countries in this region, and which are the subject of other papers in this conference).

Section 1 examines the structural reasons why the poor might be impacted adversely as a result of the Global Financial Crisis that began in September 2008, and suggests five reasons why the impact on livelihoods is a source of concern for governments. However, it should be clear that the current crisis is not the making of Asian governments – quite unlike the Asian Economic Crisis of a decade ago. The East Asian economies are in a much stronger position now to withstand an economic crisis – that is the subject of Section 2. Nevertheless, East Asian policy-makers will need to recognize that the US financial meltdown signals a paradigmatic change in the way the global economy is likely to function in the future. The unsustainability of large US budget and current account deficits means that the US will not be in a position to absorb exports from around the world to the same extent; this is a change that East Asian economies will need to adjust to in the long run (section 3). While most of the discussion in these sections is cross-national, section 4 deals with two economies in the region – one low income (Cambodia) and one middle income (Indonesia) – that exemplify some of the policy concerns that governments must address to meet the income and livelihood needs of their poor. The final and longest section discusses specific actions that are needed to address their needs that are suggested by the preceding analysis: initiating social insurance and social assistance mechanisms for workers in the informal economy; a fiscal package to stimulate domestic demand and offset the falling employment in export activities; and a focus on agriculture, especially food production, that will have multiplier effects throughout the economy.

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<sup>1</sup> Only the city-states of Singapore and Hongkong and South Korea belong to the high-income category of countries, while Malaysia is a high-middle income country. The rest of the countries under consideration are either low income or low-middle income countries.

## **I. Structural reasons why vulnerabilities of poor should be a cause of concern for governments**

It is commonplace now to say, at least for the last decade or more, that **Asia is the engine of world economic growth**, given that East Asian economies, followed by South east Asian ones, and in this decade India, have been growing at historically unprecedented rates, while at the same time their population growth rates have either plateaued or on the road to stabilizing. Nevertheless, the **largest number of poor in the world are in Asia**, more than in Sub-Saharan Africa.

Despite rapid and sustained rates of growth for several decades, that resumed soon after the Asian economic crisis of a decade ago, we know that there are still structural reasons why an exogenous shock like the Global Financial Crisis can impact the poor in East and South east Asia adversely. In this section we examine those structural features of these economies why vulnerabilities of the poor should be a cause of concern for policy-makers.

### ***Significant proportion of the East Asian population is still poor***

While \$1 a day at purchasing power parity should be seen as an extreme poverty line, at least in the East and South east Asian context, \$2 a day should be considered as a poverty line below which live people that are highly *vulnerable* to exogenous shocks, and hence potentially liable to sink into extreme poverty if not supported through state benefits. As **Table 1** shows, Indonesia, Malaysia and Thailand have very low shares of the total population below the \$1 a day poverty line. However, even these countries have significant shares of their population living below \$ 2 a day (Indonesia 52%, Thailand 32.5%). Meanwhile, Cambodia (34%), Laos (26%), the Philippines (14.6%) and Vietnam (17.7%) have significant shares of the population below the \$1 a day poverty line.

Governments usually do not care much about international poverty lines, which are normally used only by international agencies for cross-country comparisons. In any case, there are major theoretical and methodological problems with the \$1 or \$2 a day poverty line (recently updated by Ravallion from \$1.25 from \$ a day) (see Reddy and Pogge, 2006; 2007; 2008). But the relevant estimate for policy-makers within the country is the national poverty line (see column 4 in Table 1), which show that the incidence of poverty is in the range of 8% in Malaysia to Laos (39%). Cambodia (35%), Vietnam (37%), the Philippines (28%) and Indonesia (17%) are other countries where the level of poverty, as defined by national governments, is probably a source of concern.

Income inequality in the East Asian economies has not been high by international standards (e.g. Latin America and East European countries have much higher levels of Gini coefficients). **Table 2** shows that the highest level of Gini is in Thailand (.499 in 2004); the rest of the countries are well below that level. There does not seem to be any evidence that in the decade and a half from 1990 to 2004 the Gini coefficient of income distribution has been systematically rising (except to some extent in Indonesia). There was indeed clear evidence that prior to the Asian economic crisis the Gini was rising

between 1990 and 1996 in almost all countries, but since then there does not seem to be evidence that it has been rising.

*The share of the workforce in the informal economy is very large in all countries*

The poor are most likely to be those engaged in informal employment, without any social protection whatsoever. In economies where the share of informal sector employment is very large (as in South east Asian countries) it is critical that all kinds of income are taken into account to form a view about what might be happening to well-being of those in the lower income deciles of the population. Informal employment (and self-employment) is particularly large in the low-income economies of the Mekong delta (i.e. Laos and Cambodia, in addition to Burma although information about the latter is much less robust. But even in Philippines, Thailand and Indonesia the informal sector share of employment is quite large (see Table 3). Thus, in Indonesia in 1999, 31.6 million of the 38 million agricultural workforce was defined as ‘informal’. Similarly, in the non-agricultural labour force, exactly half (or 24.9 mn workers) were informal employment. In other words, in total the share of the informal labour force in the total labour force was 63.6%. Given that the share of the poor in the total Indonesian population is only 17%, while the proportion of those in informal employment is as high as 63.6%, a relatively small proportion of informally employed are actually poor. However, the informally employed are likely to be highly vulnerable to exogenous shocks to their income and livelihoods – especially those who are employees rather than employers within the informal sector.

Table 3b shows that in all sectors taken together the share of informal employment in total employment in the Philippines is 81%, while in Thailand it is likely to be 78% or so (given that the entire agricultural labour force will be informal). All these households are without any social protection that are available to those employed in the formal segment of the economy.

*Share of workforce in agriculture still very large, yet agriculture neglected*

Households in the lowest expenditure categories still derive a larger share of their total income from agriculture when compared to households in higher income groups (Davis et al, 2007). Yet policy-makers tend to ignore agriculture relatively, since the share of industry and services in GDP is overwhelming in the ASEAN countries. Even in Vietnam, 80% of GDP is derived from industry and services together (40% for each); in Malaysia it is even higher at 92% of GDP (see Table 4). Even though these sectors might account for a relatively small share of total employment, these are perceived as the lead sectors, since they are characterized by relatively higher productivity compared to agriculture.

Nevertheless, agriculture is not unimportant even for its contribution to total GDP, especially for Cambodia (33%) and Laos (45%)., but even for Vietnam (20%), the Philippines (19%). But much more importantly, agriculture’s employment share is what should concern policy-makers: in descending order of importance within the ASEAN

countries, it is 71% for Cambodia, 68% for Vietnam, 44% for Laos, and even for middle-income countries like Thailand it is 42% and for Indonesia 44%. In other words, policy-makers ignore agriculture at their own peril, at least politically, if not economically. If agricultural incomes rise, they can boost domestic consumption demand, and thus serve as a countervailing force which could offset the decline in external demand due to the Global Financial Crisis.

*Food self-sufficiency ratio declining, while import prices have been rising*

According to FAO (2006a), food self-sufficiency (production/total demand) is projected to decline from 97% to about 90% in East Asia. At the same time, comparing Q4 2007 with Q4 2003 (the latter year was one when international oil, cereal and fertilizer prices were relatively stable) world market prices increased 56% for rice, 91% for wheat, 40% for maize and 107% for urea (the main fertilizer used by Asian farmers).

The real issue is to what extent were these rising world food prices passed on to consumers. We dwell mainly on rice here, since that is the staple in the entire region. Dawe (2008) argues, on the basis of an analysis of five East Asian countries (and two South Asian ones) that the pass through (i.e. domestic price/world price) was the highest in Thailand (53%) and Indonesia (41%), followed by China (36%), and the lowest in Vietnam (11%) and the Philippines (6%) (for comparison, pass through in India it was 9% and in Bangladesh 43%). The Philippines (and India) had the lowest pass through of world prices on to domestic consumers, because of the use of government storage, procurement and distribution as well as restrictions on international trade (Rashid et al, 2005). Vietnam, which also had low pass through, uses variable export restrictions of different kinds. As a result of stabilizing action by this group of countries, domestic prices are more stable than world prices.

Thailand and China, on the other hand, do have some government intervention in terms of procurement and storage, but domestic retail prices do follow world prices pretty closely.<sup>2</sup> Indonesia, according to Dawe (2008) and Mishra (2008), has stabilized domestic rice prices, but these prices have been more volatile than international prices during the current decade. Domestic rice prices in Indonesia have risen sharply in the past few years as rice imports were contained with a view to raise farm incomes even when world prices were stable.

Thus, given that food self-sufficiency is declining, it is critical that in conditions of rising world food prices there are measures in place to ensure that the poor and those in the informal economy, and net food buyers in rural areas are protected against the pass through of world prices to domestic consumers.

There is a longer-term issue here which governments will need to recognize. A source of insecurity or vulnerability for East Asian economies, and their poor populations, may derive from the combination of trends in food self-sufficiency, recent trends in food

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<sup>2</sup> The main difference between Thailand and China in respect of grain trade domestically is that the latter does not allow the private sector to trade at all.



prices, and also the commercialization of agriculture. While the recent trend in food prices may get reversed, the trend in food self-sufficiency and commercialization are long-term trends that are unlikely to be reversed. When there is food insufficiency the gap between supply and demand is met from imports, which makes food deficit countries vulnerable to international price changes. More importantly, within food deficit countries it is the poor with lower purchasing power who might find themselves unable to purchase food from the market. Table 5 shows the share of household expenditure spent on food among the poorest 30% of households in some key Asian countries. In Lao PDR it is as high as 81%, in Mongolia it is 70%, in Vietnam 53% and in Thailand 48% (see Table 22), and in the Philippines for the poorest two quintiles 60% of household expenditure is devoted to food (World Bank, Philippines, Household Income and Expenditure Survey, ??).

In this context, the growing commercialization and diversification of agriculture in contrast to the former pre-occupation with cereal crop production, especially rice, can pose a threat to the poor. With growing urbanization (41% of East and South east Asia's population was in urban areas in 2004, which will rise to 51% by 2015), with most cities in the South east and East Asian region located on the coast, food imports can sometimes be cheaper than food supplies from the hinterlands, especially where the national communications and infrastructure links are poor (e.g. northern Myanmar). With the declining food self-sufficiency ratio (noted above), there is an increase in food imports which should naturally worry governments at a time when food prices are on an upward surge. With growing commercialization of agriculture and urban concentrations of population growing in coastal locations, falling food self-sufficiency implies that these countries will rely more on food imports than in the past – making them more vulnerable to international price trends. That puts a burden on governments to ensure that the pass through of world prices is regulated in such a way that poor consumers are not impacted, while the benefits of rising farm gate prices are not denied to farmers.

#### *Share of exports in GDP is far higher than in comparator countries*

Of all groups of countries in the world, East Asia has the highest proportion of export to GDP ratio (66% as opposed to 44% for developing countries) (UNDP, 2007). Way back in 1990 the East Asian share of exports in GDP was 34% (see Table 6), and then too it was the highest for any region of the world. But since then it has grown very sharply indeed. Clearly, with the collapse in output in the US and declines projected in Europe in the wake of the Global Financial Crisis, East Asia will be seriously impacted. Sectors that are highly dependent on exports in each of the East Asian countries will naturally be impacted, and it is for policy-makers to identify the employment-intensity of exports by sectors in order to determine what should be an appropriate policy response.

At one extreme we have Hong Kong (export to GDP ratio of 198% in 2005) and Singapore (243%). Malaysia's exports account for 123% of GDP (compared to 75%). But the more populous countries have also shown increasingly reliance on exports to drive

their economic growth: Thailand 74%, China 37%, the Philippines 47%, Vietnam 70%, Indonesia 34%. Even the low income countries are heavily export dependent, Cambodia (65%) more so than Laos (27%). There was a recognition after the 1997 Asian crisis that Asia needed to move away from export dependence towards domestic driven growth. But this was not acted on. Rising export to GDP ratios indicate that most of the Asian economies have become even more export driven after 1998.

Malaysia, Thailand and Vietnam are among the economies most exposed to the global demand downturn. Malaysia in particular, is at risk of following Singapore and Hong Kong into technical recession. The export drag in Malaysia will be magnified as volume effects from weak global demand are reinforced by the price effect of lower oil and commodity prices (both of which are major Malaysian exports). The near 40% electronics share of total exports leaves Malaysia fully exposed to the downswing in the global electronics cycle. This will be compounded by sharply falling oil and commodity export revenues which comprise over 35% of Malaysia's total exports. Recognising this, the government has resorted to aggressive fiscal spending in order to support growth.

Vietnam's large export to GDP ratio is largely commodity based. The correction in oil and commodity prices will affect more than 50% of its exports. Electronics exposure is relatively low at only 4% of total exports.

Thailand looks like a mirror image of Malaysia. Thailand will benefit from lower oil and commodity prices through a gain in its terms of trade suggesting a greater resilience to the global downturn. However, this would be an incorrect assumption. Thailand's terms of trade gain will provide relief on the balance of payments and reduce input costs for manufacturers. But any cost relief will be swamped by sharply falling global demand with Thailand's vulnerability highlighted by its 74% export to GDP ratio. This includes a large component of electronics exports, 16% of total exports (or 28% of total exports on a wider definition including machinery and electrical appliances) and autos and auto parts exports with a 9% share of total exports. Both electronics and auto exports will be hit by sharply falling demand from the industrialised countries. There will be additional export revenue losses from the falling price of agricultural goods (10% of total exports).

Indonesia should be most insulated against the global downturn given its large domestic economy and an export to GDP ratio of only 2% (as of 2007 figures). However, Indonesia's wealth is generated from its extensive resources. This remains a commodities driven economy. Private consumption may be the dominant component of GDP at over 60% but as we saw this year, consumption has been largely fueled by the commodity price boost to rural income. Commodities comprise over 40% of Indonesia's total exports, excluding the 20% share of oil & gas exports. Falling commodity prices will curb growth primarily through reduced consumer spending, along with slowing export growth and exchange rate pressure from the narrowing current account surplus and likely shift into deficit next year.

The Philippines is one of the few Asian economies where the export to GDP ratio has fallen over the last ten years (in fact from 47% in 2005 to 34% in 2007). This reflects a structural shift from manufacturing to a services driven economy. However, services expansion has not been sufficiently extensive to cushion the economy, being limited to sectors such as BPOs which will not be immune in a global downturn. Moreover, the low 34% export to GDP ratio obscures the heavy concentration of electronics goods. Electronics (using a broad definition) comprise almost 60% of total exports underlining the Philippines' exposure to the global tech sector downswing.

In other words, the East Asian countries growth prospects, as well employment in the export-oriented sectors, will be impacted adversely as the economy of the main market for their products, the US, slows significantly. *That there will be a short-run impact on the East Asian economies is almost certain, and exporting countries will probably be forced to search for either domestic markets or other markets for the same products. However, whether there will be a longer-term impact on their strategy of export-oriented growth is an issue we will return to later in the paper.*

## **II. Why ASEAN countries are less vulnerable now compared to post-1997?**

In the last full year before the financial crisis broke in 1997, GDP growth in the ASEAN countries on average was a solid 7.3% (Table 7 shows time trends from 1996 to 2005). It has never recovered that rate of growth on average. That should not be taken to mean that individual countries in the ASEAN region did not grow faster than the ASEAN on average. Thus Vietnam and Cambodia have grown at rates usually higher than the ASEAN countries on average ever since the crisis of 1997.

A fundamental difference between the Asian Economic Crisis of 1997 and the current one is that the former started with the East Asian economies, in particular, Thailand. By contrast, the current crisis started in the USA, and it is contagion that the East Asian have to worry about this time around. The fact remains that the East Asians have remained in sound economic condition over the last 10 years.

The Asian Economic Crisis convinced these countries to improve the viability of their banking system, to improve corporate governance by lowering their debt/equity ratios, and by strengthening their regulatory framework for the financial sector and also accumulating much larger foreign exchange reserves to prevent currency speculation (Jomo, 1998; Mishra, 2008).

All the 10 ASEAN economies, except Singapore (its most high-income economy) are not heavily exposed to the banking practices that triggered the current crisis in the US. This fact must be kept in mind as a reason for the far lesser impact of the Global Financial Crisis on East Asian populations. Singapore, in any case, has always had the benefit of serious state oversight, and its population too has remained relatively immune to the financial crisis. In fact, the political leaders of the 10 countries have, at a summit,

emphasized that the ‘financial sector [in South east Asia] remains solid and sound’. Their ‘confidence’ is due to the reality that ‘stand-by liquidity [or cash flow] is available to respond to any emergency need’ within the sub-region. In fact, this sub-regional initiative is itself the outcome of the Asian financial crisis of 1997; in other words, the earlier crisis has prepared these countries for the current one.

ASEAN had developed during the 1997-2000 crisis, a cooperative financial arrangement, called the Chiang Mai Initiative, that involved the 10 ASEAN countries plus China, Japan and South Korea. The last three countries have very large foreign exchange reserves, and the Initiative posits that they can provide liquidity to any country in the region that suffers from a short-term liquidity problem.

This is not surprising that such an Initiative became reality, since the US had torpedoed the attempt in 1997-98 by Japan to launch a Asian Monetary Fund, to mirror the International Monetary Fund. The AMF was intended to focus on the East Asian economies, and would have provided liquidity, just as the IMF – with the difference that the IMF has done it under severe conditionalities, and without regard to different conditions prevailing in the economies that seek a loan from them. The US prevented Japan from initiating the AMF, which the US feared would provide competition to the IMF in the Asian region. It is another matter that by the early part of this decade, the IMF had become all but irrelevant for the middle-income economies of the world, especially but not only in Asia. In any case, the foreign exchange reserves of most economies of the East Asian region have grown significantly since the late 1990s.

Besides, the Chiang Mai Initiative is already in existence to blunt the potential effects of a financial crisis in the region, were it to occur. To bolster this effort, in October 2008 Thailand suggested the formation of an ‘Asian financial community’, consisting of the 10 ASEAN countries and China, Japan and South Korea. At the Asia-Europe Summit in Beijing (Oct 24-25, 2008), the most concrete idea discussed was to set up an \$ 80 billion fund by the middle of 2009 to help countries in the region deal with problems of liquidity (a plan already agreed in May 2008). The bulk of the money would come from China, Japan and South Korea (but details have yet to be announced). For China, with \$1.9 trillion reserves, and Japan, with nearly \$ 1 trillion, the proposed amount is hardly massive. The creation of this fund will show how much the economic scenario has changed since the Asian financial and economic crisis of 1997.

#### *The reality post-1997 vs current projections for 2009*

The most important proposition that should be understood about the short-run is that this crisis for East Asia is much shallower than the one post-1997, but actually deeper than the one that was being anticipated until the third quarter of 2007. Share prices in East Asia have fallen by an average of two-thirds (in dollar terms) – almost as much as they fell during the crisis a decade ago in Asia. Japan is already in recession (defined as two successive quarters in which output declines). Taiwan is also technically in recession (by the same definition). Its GDP fell by 1% in the year 2008 to the third quarter, taken down

by a sharp decline in exports and also weak domestic demand. JP Morgan's forecast is for no more than 1% in 2009 for GDP growth.<sup>3</sup>

Similarly, although South Korea's exports have held up so far, but the large debts of its households and firms are a source of uncertainty ahead. However, the government has already acted speedily to bail out its banking system, and its comfortable fiscal situation will help to cushion the impact on the economy since it is in a position to put in place a fiscal stimulus.

The most important point that stands out from the **Graph 1 – showing the GDP change on year earlier in 1998 and forecast for 2009** – is the following. Most countries in 1998, the first full year after the Asian crisis broke a decade ago, saw actual declines in output in Indonesia, South Korea, The Philippines, Thailand, Malaysia, Hong Kong and Singapore. On the contrary, except for Hong Kong, no economy of the region is expecting an actual decline in output. There is a slowing of output growth in 2009 expected as compared to that in 2008, but output and incomes will actually increase in the region, albeit at a slower rate.

Even more importantly, all analysts believe that Asia will recover faster than other parts of the world, precisely because most East Asian economies have been well managed since the crisis a decade ago. Public debt-to-GDP ratios are comfortable, and well below the average for rich countries. In 1997, almost all had relatively large budget deficits (**see Table 8**), and although the deficits persist they are smaller, by and large. China, Malaysia, South Korea, Taiwan and Thailand have already announced a fiscal stimulus (and Singapore and Hongkong are about to do so).

All the countries have current account surpluses (**see Table 9**), including even Laos and Cambodia in the latest year for which data is available (2006, although prior to that they had small deficits). On the contrary, in 1997 almost all the ASEAN countries had current account deficits (see Table), the worst being Laos (-10.2% of GDP). Besides, as noted earlier, all have larger foreign exchange reserves.

### **III. Source of vulnerability in ASEAN economies in the long run**

Having said this, it is true that the ASEAN economies have much higher trade to GDP ratios, and are much more integrated into the global economy than most South Asian economies (as we argued earlier). In the long run, what the Global Financial Crisis and the economic slowdown in Europe and North America is likely to underline is that such high and rising export to GDP ratios – that have been drivers of unprecedented growth in East Asia – may not survive this crisis, which have implications for livelihoods throughout the region.

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<sup>3</sup> The government announced in November 2008 that it would give everybody NT \$3600 in shopping vouchers to spend in shops and restaurants.

The most important issue of longer-term salience for the development strategy in the region is as follows. ASEAN and East Asian economies managed to grow, following the Japanese model, through export-oriented manufacturing growth from the 1970s onwards. This is fairly well-known, and has been fairly well discussed as the flying geese model. This resulted in export to GDP ratios rising sharply over a period of less than two decades. The US accounted for a very high share of these exports.

In balance of payment terms this meant that while the Asian economies were developing trade surpluses with the US, they were also growing their foreign exchange reserves, mainly held in US dollars. The other side of this coin was that the US current deficit continued to grow. The only way in which this system could be sustained is that the Asian central banks held most of their earnings in US Treasuries. However, with the financial meltdown that has occurred in the US, and the recession that had already begun since the last quarter of 2007 in the US has deepened, and is likely, according to most US commentators and analysts till at least 2009 (at least the technical recession, though slow growth may resume thereafter).

Over this same period the US current deficit to GDP ratio has grown very significantly (to roughly 8% of GDP). At the same time, the US budget, which was in surplus after strenuous efforts made by the Clinton administration (1992-2000) to reverse the profligacy of the Reagan and elder Bush administration (1980-1992), has now after a eight-year Republican administration (2000-2008) a large budget deficit. The sustainability of this dual deficit, on the budget and the current account, has long known to have been in doubt. It had to be reversed, and now under the influence of the financial meltdown and economic recession, there is little doubt that it will have to be. The impact of this reversal will naturally have a long-term impact on the export-led growth strategy of the East Asian and ASEAN economies.

There is an increasing sense that the US economy's ability to absorb Asian exports indefinitely will therefore be in question. In other words, the long period of export-led growth in the relatively small economies of East and south east Asia will slow down considerably. On the other hand, countries like China (and India), with much larger domestic markets, where the investment in any case has been driven by large and growing domestic savings, and demand by large and growing domestic markets, the current decline in export earnings will simply be a blip on the screen for a year or so. In fact, these economies will be the first ones to which investors, both foreign institutional investors (FIIs) in the capital markets as well as foreign direct investment (FDI) in productive assets will return fastest, for two reasons: first, there will still be fewer opportunities in their own economies, as well as the rest of the world; and second, growth in both China and India is not projected by any analyst to drop below 9% pa in China and 7% pa in India.

Nevertheless, the long-running period of rapid growth driven by exports of manufactures from East Asia and the ASEAN economies is unlikely to return to the trends observed over the last three decades. The US had emerged from World War II with over half the intact production capacity of the world. But the US policy-makers faced two fears. One

was that the world war's high demand, which had pulled the US and European economies out of the Great Depression would subside with serious consequences for both output and employment in these economies. The other was that communism would take advantage of the war's devastation to take over parts of the world (Murphy, 2008). The US response was to put in place a Keynesian demand stimulus at home, and the Marshall Plan abroad for Europe (and Japan). The corollary was that the US would accept the exports manufactured to pay for aid, without reciprocal demand for imports from the US. Japan focused on accumulation of dollars so that it could buy the capital equipment it needed. This was the beginning of the east Asian export-oriented model of development.<sup>4</sup>

Japan emerged in the process as a major world economy by the 1970s, and then a slew of Newly Industrializing Countries followed Japan's model of export-led growth, in what came to be known as the flying-geese model. First, Korea, Taiwan, Hong Kong and Singapore, and then the second tier countries of Malaysia, Thailand, Indonesia, and then China, and then later still Vietnam (and India), all followed Japan's model in building internationally competitive export activities, and also followed Japan in accumulating foreign exchange reserves in dollars. This trend accelerated after the Asian economic crisis of 1997 (see Table 6). The policy impact of the Asian Economic Crisis of a decade ago within Finance Ministries of Asian countries was to resolve that the IMF would never again be permitted to dictate policies. Since it was capital flight that had precipitated the crisis, those countries that suffered the most in the crisis (i.e. Thailand, Indonesia, South Korea) and even those that suffered much less (Malaysia) or not at all (China) were determined to prevent a future recurrence – and hence went on accumulating dollar reserves.<sup>5</sup>

However, the implication of accumulating dollar reserves is that it is equivalent to leaving to depositing East Asian export earnings in the US banking system where they have been used – as we have been discovering since mid-September 2008 – inter alia, to finance the building of homes for people who did not earn enough to afford those houses. The latter phenomenon allowed the development of a fiction of a credit boom supported by financial products in the US economy that eventually led to a financial meltdown. It also allowed the US administration to provide tax cuts to the richest in an economy while public expenditures soared to accommodate wars in West Asia (Iraq, Afghanistan) and also high health care costs in the most cost-inefficient healthcare system of the rich world.

The implication is that the US economy is unlikely to recover without more domestic savings (as opposed to using foreign savings for driving consumption and growth in the US). Gross savings in the US are 12% of GDP, one of the lowest in the world (and net

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<sup>4</sup> This meant that the accumulating export surpluses of Japan (but also Germany) – and their mirror image in the trade deficits of the US – until the 1970s could not be accommodated in the rigid international financial architecture that had been created by the Bretton Woods system. The system, which required the US to back the dollar by gold while other participants maintained fixed exchange rates with the dollar, collapsed in 1969. The new system was premised upon the willingness and ability of non-US dollar holders to continue to hold stores of dollars.

<sup>5</sup> Their trade with the Euro zone is not large enough to allow the euro to substitute for the US dollar as a reserve currency.

savings 2% of GDP after allowing for mortgages and credit card purchases). Compare those to found in China or most ASEAN middle income countries of 35 to 40% of GDP, and India of 35% of GDP. US savings will need to rise in the near future, and exports will have to rise (while imports are contained). This will constitute a reversal of a trend prevailing for the last four decades, and that will involve a painful transition in east Asia as well. The export-led growth that East Asian countries have become used to will slow considerably over the next decade – that is, the long-run.

*Clearly, the implication of this is that East Asian governments will need to sharply focus their attention to the top 10 export sectors of their economy to determine what the impact on employment, output and incomes will be for those sectors, and for associated sectors that have backward linkages and are input providers for exporting sectors.*

#### **IV Case Studies – Cambodia and Indonesia**

In this section we examine one least developed (Cambodia) and one middle-income country (Indonesia) to get a better sense of the issues involved, and the vulnerabilities that could or should be addressed. Cambodia was chosen since it might also highlight the problems of small countries with small populations at similar levels of development (e.g. Laos, Timor Leste). On the other hand, Indonesia has the largest population after China in the region; it is also the country that saw the greatest political turmoil after the Asian economic crisis. It is also different from the other ASEAN economies in that export/GDP ratio is much lower at 27% (2007); and while we have managed to discuss at some length (within the limits of one paper) such a large number of countries, it is also important to discuss a large, middle-income country to show up the particularities of country situations – so as to demonstrate the limitations of such cross-country analysis, which by definition cannot capture the specific actions that might be needed to address the impact of a global economic crisis.

##### ***Indonesia***

Indonesia was the one country most affected in the region by the Asian Economic Crisis of a decade ago, having experienced a virtual systemic collapse of its economic and political system, almost on the scale of the former Soviet Union and many East European countries. Yet, by early 2008 “Indonesia seemed to be on the verge of reaching its pre Asian Economic Crisis levels of economic growth but with better economic governance, greater political stability and transparency and a steadily improving legal structure” (Mishra, 2008).

Indonesia enjoyed many of the characteristics of sound economic growth since the political and economic turmoil that followed the Asian economic crisis a decade ago: a stable exchange rate (see Table 10); low public debt ratio to GDP; foreign direct investment returning after several years of net outflows (Table 11); rising international reserves; inflation rates that were tolerable (even though among the highest in ASEAN), except for food. It is not surprising then that recognition of the impact of the global financial meltdown of 2008 came relatively late. It took plummeting stock market



indices and sharp depreciation of the national currency for several economies of the region to bring home the fact that global financial crisis was not yet another event in the US or Europe (Mishra, 2008).

Industry has a very high share in total output in Indonesia (see Table 4 on GDP share of Primary, Secondary and Tertiary Sector in ASEAN economies), the highest for any middle-income country in the region; only Malaysia (44%) and Thailand (44%) come close to the salience of industry in their economy. In the case of Indonesia, this salience of industry is driven by the paramount importance of the oil sector in its economy. Awareness of the global financial meltdown and its possible impact came slowly in Indonesia. The government had remained focused on the social and political costs of oil price and food prices increases throughout 2008. The domestic fuel subsidy in Indonesia has been large; its fiscal costs rose very sharply as international oil prices rose to nearly \$ 150 per barrel, which prevented the government from meeting critical public expenditure needs to ensure the supply of basic public goods and services. (What is ironic, however, is that the government allowed the pass through of rising world rice prices to the poor (as we discussed earlier), while the general consumer was protected from rising fuel price increases).

In all cases where subsidies are not targeted but are universal, the issue that the government needs to consider is whether incremental fiscal costs of say, increasing expenditures on agriculture or on social insurance for workers in the informal sector (both suggested below as a response to the economic crisis that started in late 2008), are going to be less or more than the total costs of existing fuel subsidies. In the budget of 2008, the opportunity costs of the fuel subsidy are plain. Infrastructure and social development expenditure suffer. The infrastructure deficit is clear from the following: the electrification ratio is 53% (placing Indonesia at 11 in regional ranking of 12 countries), access to sanitation 55%, access to clean water 14%. Yet the total fuel and energy subsidy is Rp 220 trillion, while expenditure on social sectors (health, education) is Rp 30 trillion and government spending on infrastructure is Rp 80 trillion. Clearly, there will be no alternative to reducing the fuel subsidy, doing which is now easier given the dramatic decline in world oil prices. The fiscal space created by falling oil prices would enable a fiscal stimulus package to be put in place, focusing on infrastructure and the social sector.

This would be necessary because of two features of the resumed economic growth since the Asian Economic Crisis are the stickiness of the unemployment rate (see Table 12), which is the highest for the ASEAN economies; and also of the poverty ratio. Unemployment has not responded to the resumption of economic growth, and in fact the numbers of young, urban unemployed has increased. Mishra (2008) notes that “this reflected both the rapid pace of urbanization in Indonesia during the high growth decades since the late 1970s as well as the fact that the period of easy, labour intensive, low-technology growth was coming to an end”. In fact, the economic crisis of a decade ago resulted in the transfer of segments of the textile, garments and other labour intensive productive capacity to lower wage economies in the Asian region (e.g. Cambodia). The youth are the ones most affected. Despite resumed economic growth between 1998-2000 and 2004-06 unemployment rates for the 15-19 year olds have barely fallen from 29.7%

to 27.2%; for 20-24 year olds from 37.3% to 34.1%; for 25-29 year olds from 18.1% to 14.7%; and have risen sharply for 30+ year olds from 15% to 24%.

The poverty ratio had fallen dramatically from 54% in 1976 to 11% in 1996, but it rose to 24% in 1998 as output fell sharply, the highest for any ASEAN economy (see Table 6). As growth resumed, the poverty ratio fell to 19% in 2000, but has barely fallen despite reasonable GDP growth this decade to 16.6% of the population. In fact the Gini coefficient has risen slightly this decade (see Table 2), as shown by household surveys, as asset concentration remains persistent, which suggests that either growth must rise significantly for poverty to fall, or social investments must increase sharply to enable an improvement in human capabilities.

Meanwhile, the government has focused its attention in the last three months on an anti-inflationary policy (it raised its overnight policy rate by 25 basis points to 9.5% on October 7 after inflation hit a two-year high); and on containing the possibility of a run on the currency and reserves by agreeing with the World Bank a stand-by loan of \$2 billion (October 11), to be taken up if economic growth slows to 5.8% in the first quarter of 2009. Similarly, building on the Chiang Mai Initiative in which the 13 nations set up bilateral contracts to supply funds through currency swap lines (see earlier discussion), in October 2008 the ASEAN Plus 3 (i.e. Japan, South Korea, China) recommitted themselves to establishing a US\$ 80 billion emergency fund (to which the Plus 3 would contribute 80% of the fund, the ASEAN countries the remainder) by June 2009.

### *Cambodia*

Cambodia, one of the poorest countries of the region, has experienced remarkable growth in real GDP of 9.3% pa over the period 2001-2006 and 10.4% growth in 2007. The impetus to growth came from industry, which is evident from table 4 which shows that the share of industry grew from 23.3% in total GDP in 2000 to 30.5% by 2005, which is unprecedented by historical standards in such a short time for any country. It was the garment and construction sub-sectors that grew fastest, but so did tourism. The high growth rate has also supported a higher rate of savings, which can cushion the price shocks (especially in fuel and food) that have been experienced recently.

But the most important point for our analysis is that in 2007 Cambodia's agriculture accounted for 26.7% of GDP and employed 57% of the labour force. Moreover, 65% of the rural households are either landless or land poor (owning less than one hectare), according to the Cambodia Socio-Economic Survey 2004. One hectare of rice land is the borderline that produces a bare minimum of rice sufficient for consumption by one household of five, assuming the whole produce can be kept for consumption. Hence, the majority of rural residents do not produce a surplus of paddy but are net buyers. Along with world prices, domestic food prices jumped significantly – for rice by 100% between May 2007 and May 2008, for meat by 50-70%, and for fish by 20-30% (CDRI Survey, 2008). If the poorest 40% of the population spend 70% of their expenditure on food, almost the entire population were adversely affected by these price trends, but especially those in rural areas who are net buyers of food; the urban poor would be next worst

affected. On the positive side, wages from day-labour, the main source of income for the landless and land poor groups, increased by around 50% in the same one year. But only those would benefit where work is available. Using WFP's definition, the survey found that 19% of the households in Cambodia did not have "acceptable" food consumption (of which 7% had "poor" and 12% had "borderline" food consumption), and the rest 81% had acceptable food consumption. About 50% of households reported cutting back food consumption as a way of coping with the rising food prices. In a country where child stunting already affects 40% of the population, the nutritional status of a large section of population is further threatened.

Of serious concern, the survey found, was that fishing communities were among those most severely affected. With doubled rice prices, the fishing households were pushed into deeper poverty. Although the price of their produce is rising (with all round inflation), fish prices have risen only by about 20% and that has been accompanied with rising input costs.

Many rice producers (some 35% of the total) have benefited from the sharp increase in rice prices, as rice production is more profitable in 2008 than in 2007. Dry-season rice farmers found their gross margins were up by 32%, and although the CDRI survey was complete by the time wet season rice was sown, margins should be up 40%, after allowing for increased input costs. This also applies to cassava, soybean and maize farmers. Rather than reduce inputs of fertilizer, whose prices doubled or tripled, the response of farmers of the rice in farm gate prices would be to seek credit and purchase fertilisers on loan. Thus despite higher production costs, net selling farmers have seen a remarkable increase in farm gate prices and hence incomes.

However, there are long-standing constraints, the survey finds, that limit the expansion and intensification of agricultural production. Lack of capital is one. About half the households are now in debt, and they need to borrow more money to afford rising production costs. But this requires that government agencies providing credit will need to act, so that farmers are not forced to borrow at high rates from non-institutional lenders. Although inflation rates in Cambodia were relatively low throughout this decade (see Table 13, the minimum lending rates in Cambodia were the highest in the ASEAN region (see Table 14) and well above the inflation rate (though the lending rates that apply to the agricultural sector may in fact be lower). Yet the survey recognizes that interest rates are a problem. Poor agricultural extension services and lack of public investment in irrigation systems are also mentioned by the survey. Finally, land disputes is mentioned by the survey as a major constraint to agricultural production expansion, since disputed land is left idle. These are clearly areas for action by the government in order to improve livelihoods.

More broadly, the global financial crisis will hit countries like Cambodia and Laos through the usual predictable channels: collapsed commodity prices, reduced export demand, more cautious/slower FDI in resource sectors, and probably eventually tighter ODA. Presumably lower petroleum prices will eventually reverse some of the higher costs for transportation and fertilizers. The correction/depreciation of local currencies due

to a flight from risk (including portfolio investment withdrawals from stock markets in emerging economies) should improve the terms of trade for the agricultural sector in such developing economies. This in turn would help offset to some degree some of the other negative factors listed earlier by further increasing incentives for a supply side response and increased local food production. But this will also depend upon marketing structures in the countries concerned: middle traders who may attempt to capture much of the gains (as happens in countries like Laos and Cambodia), and actual prices received at the farm gate may not improve.

## **V. Addressing Vulnerability among the Poor in ASEAN economies**

The preceding analysis suggests that governments in the region need to follow five sets of actions to mitigate the impact of the Global Financial Crisis on the poor, address their vulnerabilities, and increase incomes:

1. Initiate social insurance for those in the informal sector
2. Initiate social assistance (e.g. CCTs of the Indonesian kind)
3. Initiate a growth strategy that increases production in agriculture (including fisheries), where majority of the population is still concentrated in many countries (Laos, Cambodia, Vietnam, Thailand, Philippines, Myanmar); reduce market volatility in agricultural products, especially food items, by building food stocks and periodic government intervention in the market to stabilize food prices.
4. Focus selective export-oriented activities for tax and subsidy packages. Identify top 10 exports by country, characterized by highest employment-intensity and high income-elasticity of import demand (in rich country markets) for government support.
5. Initiate a fiscal package to stimulate demand domestically, since growth of domestic demand from middle-classes can offset to some extent fall in exports. Public debt to GDP ratios are low in most ASEAN countries, and fiscal deficits are low – so there are few fiscal constraints. Public spending will be relied on to support growth. The problem though, is that fiscal flexibility will be curtailed by declining fiscal revenues as growth slows and rising deficit financing costs.

### *Initiate Social Insurance mechanisms for Families in the Informal Economy*

The poor most affected by exogenous shocks will be in the informal economy. However, outside the formal sector of the economy, there is hardly any death and disability benefit, old-age pension or maternity benefit in place in most of the ASEAN economies. Except in the low-income countries of Cambodia, Laos and Myanmar, health and education services – the basic services of which are public goods – are widely available at little or no cost to the user. But outside the formal sector employers, no employer provides two of the key components of social insurance: death and disability benefits and old-age pension (see analysis of Indonesia, Thailand and the Philippines in Mehrotra and Biggeri, 2007).

We saw earlier that over a third of the labour force is employed in the informal economy, without any social insurance. At least for those below the nationally defined poverty line, there should be a minimum social insurance programme, largely funded by the state. We have argued above that the fiscal position of almost all states in the region is sound, and deficits are low. So the fiscal cost argument is unlikely to hold water, especially if the social insurance is designed to target mainly the poor in the informal economy. That is not to say that the remaining labour force in the informal economy should not have access to a social insurance programme. In the short run, the social insurance for the poor in the informal economy should be funded almost entirely from government resources. However, for those who are above the poverty line the programme should be financed on a contributory basis, with some minimum contribution to premiums by the state.

To put such a programme in place there would need to be a legislation to create the enabling institutional structure for programme delivery as well as to guarantee a secure arrangement for funding the programme on a sustainable basis.

#### *Initiate Social Assistance programmes for Families in the Informal Economy*

It is surprising that despite the fact that most of the ASEAN economies are middle-income countries, there are almost no social assistance programmes in cash. The best-known programme is, of course, the Indonesia conditional cash transfer. However, no other country has a similar programme. Conditional cash transfers would be an appropriate method of increasing transfers to families with young children and pregnant and lactating mothers. A cash transfer, as a maternity benefit provided to only pregnant and lactating mothers of those identified as poor, would go a long way in addressing the early signs of malnutrition, which are one of the reasons for the high levels of stunting found in the region.

Since the mid-1990s demand side programmes linking cash to behaviour have been widely adopted across a wide variety of countries. Typical CCT or conditional cash transfers have been successfully implemented on a large scale in several middle-income countries. In these countries, CCTs often began as programmes for poor, rural and indigenous families with young children but have expanded to include urban households (Brazil, Mexico) or hard-to-reach groups such as internally displaced (Colombia) or disabled people (Jamaica), as well as an expanded range of sub-programmes such as secondary school completion incentives (Mexico), adult education (Brazil), psychosocial assistance (Chile), micro-credit, and housing (Brazil). Even low-income countries are experimenting with them on a small scale (de la Briere and Rawlings, 2006).

Remarkably, however, although the East Asian region mostly has mostly middle-income countries, almost none except Indonesia has a tradition of CCTs. Since CCTs can be introduced quickly direct cash transfers to bank accounts (assuming the poor have bank or post office savings accounts), these should be considered for specific target groups.

### *Needed a Fiscal Package to Stimulate Demand*

If export demand is likely to fall sharply, then domestic consumption can be increased by governments by introducing a fiscal package. As we noted earlier, the fiscal deficits to GDP ratio are low in all countries of the region, so the fiscal space is there for a stimulus package. Even the public debt to GDP ratio is low in most countries, so the risk of reducing credit rating internationally is also relatively low (except in the Philippines).

There is a scarcity of reliable and timely consumption indicators for Asean 5. Consumption trends are best gauged from the national accounts data.<sup>6</sup> But one can expect to see consumption growth slowing sharply in the fourth quarter. Similarly, private consumption growth estimates for 3Q08 in the other Asean economies will be of historical value, with a sharper slowdown anticipated in 4Q08 and through 2009.<sup>7</sup>

Private sector enthusiasts, of course, would argue against a government led fiscal stimulus. Thus, “We recognise the theoretical argument for counter-cyclical stimulus but historically, the limited effectiveness of fiscal policy in this region keeps us sceptical. Governments have been able to boost fiscal expenditure while buoyant growth and rising fiscal revenues have kept the deficit in check. But as growth slows next year, fiscal deficits could soar which would increase the country’s risk premium. This would raise the cost of deficit financing given rising yields on domestic bonds and a weaker exchange rate” (CLSA Markets, 19 November 2008). What this argument ignores is that fiscal stimulus should focus on increasing output in productive sectors (e.g. agriculture), which would have multiplier effects and increase growth. Besides, current fiscal deficits are very low by international standards in these economies, and inflows of foreign capital are unlikely to be affected any more than they would be in any case due to shortage of liquidity in the developed countries.

On a comparative basis, *Malaysia* is more convincing than Thailand on its fiscal stimulus plans. In preparation for taking over as prime minister in March next year, Mr Najib announced a RM7bn stimulus package (equivalent to 1% of GDP) focused on low cost housing, transport and social infrastructure and rural projects. There appears to be a firm commitment to

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<sup>6</sup> So far, only Indonesia has released third quarter data for 2008 (Vietnam too, but it does not have an expenditure breakdown). Indonesia’s real private consumption growth held up at a 4.8% QoQ annualised rate in the third quarter, sustaining the pace of the first half. However, as we have argued the consumption driver will be lost as the fall in commodity prices reduces rural income. This has been confirmed by retailers’ reports of declining sales in their provincial operations outside of Java.

<sup>7</sup> Auto sales are a useful leading indicator for consumption trends. These indicate sharply slowing consumption growth in Thailand and Philippines with contracting YoY auto sales in October. Data points and news flow over the rest of the year will likely reinforce the perception that Asean private sector demand will not provide an effective offset against falling exports. This has put increased reliance on fiscal spending to support growth in 2009 (CLSA Markets, November 2008).

initiate spending at the start of 2009.<sup>8</sup>

In contrast, Thailand's Bt100bn supplementary budget (also equivalent to 1% of GDP) is vague with the project proposals still to be submitted by the various ministries and disbursement of the funds not expected before March next year. The delay could be much longer than that given the unstable political situation.

Thus, with the prolonged political crisis undermining private sector sentiment, there will be no effective offset to falling exports. If Thailand's fiscal stimulus is adversely affected by politics, this would be in contrast to the response of the Thai government to the 1997 crisis, which had been reasonably prompt. In 1997 the Thai government had taken major steps in order to mitigate the social impact of the crisis (Mehrotra, 1998).<sup>9</sup>

A fiscal initiative is also likely in the Philippines but the size of the stimulus will be constrained by the high public debt ratio at 77% of GDP and risk of a vicious cycle of escalating debt service payments and rising risk premium.

Monetary policy will be the main policy lever for boosting demand with a fall in inflation triggering a 25bp easing this year and a further 100bp cut in 2009.

Declining remittances will steer real GDP growth lower in 2009.

In respect of monetary policy, all the Asean 5 central banks are under pressure to cut interest rates. But there are constraining factors. Inflation rates, albeit trending down, remain relatively high, in particular food inflation.

In the fiscal package, governments will also need to keep in mind that exports will decline, and hence some subsidies or tax breaks may be called for to benefit specific employment-intensive export sectors.

### *Focus on agriculture*

Patnaik (2008) has argued that the way forward out of the present crisis is the injection of demand through direct fiscal action by governments across the world. Just like a Keynesian stimulus was adopted in the post-second world war period, he suggests a similar fiscal stimulus today. He argues that between 1980-85 and 2000-05 the per capita cereal output in the world declined absolutely by 8 per cent, which also meant absolute decline in per capita world cereal consumption. But since developed countries witnessed an increase in consumption (especially as feedstock to produce meat), the decline was very sharp in developing countries, including in fast-growing economies like China and India.

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<sup>8</sup> Controversy surrounds the Malaysian package on the issue of its effect on the fiscal deficit. The official deficit projection for 2009 is 4.8% of GDP and the stimulus would supposedly lift that to 5.8% of GDP. But the government claims that the added RM7bn expenditure will be absorbed by declining fuel subsidies.

<sup>9</sup> At the request of the Prime Minister's Social Policy Committee constituted at the time, I had reviewed the policy measures taken in mid-1998 to mitigate the social impact of the crisis. Two major loans were contracted by Thailand with the World Bank and the ADB, precisely for this purpose.

Larger government expenditure should be oriented towards a substantial increase in agricultural, especially foodgrains, output. It is often forgotten that the industrial prowess of East Asian countries like South Korea and Taiwan was built upon rapid agriculture growth over a 30-year period from 1960 to 1990 (Mehrotra and Delamonica, 2007). Similarly, “The new paradigm must entail inter alia a foodgrain led growth strategy (on the basis of peasant, not corporate, agriculture) sustained through government spending, which simultaneously rids the world of both depression and financial and food crisis” (Patnaik, 2008). The good news is that in 2008 world foodgrain production is expected to increase by 5.3%, reaching 2.24 billion tonne, and consumption is expected to grow 3.3% to 2.19 billion, the FAO has said in its latest Food Outlook (FAO, 2008). Accounting for a large part of this year’s strong growth have been the major producing countries of Europe, where farmers were in a better position to respond to high grain prices. Farmers in developing countries, however, the FAO noted were limited in their capacity to respond to high prices by supply side constraints on their agricultural sectors. We have emphasized the same point in relation to our analysis of the constraints on Cambodian agriculture.

Nevertheless, what is important is that in the rice-eating regions of Asia production will be higher in 2008 than the already excellent performance of 2007. Thus, FAO notes that prospects have greatly improved from the early assessment made in June 08 and global paddy production is now set to reach 674 mn tonne (equivalent to 450 mn tonne of milled rice), 16 mn tonne or 2.4% above the performance of 2007. Asian countries are set to drive production this season, as they are expected to reap 611 mn tonne of paddy (408 mn tonne of milled rice), about 13 mn tonne more than in 2007. Large gains are anticipated in all leading producing countries, such as Bangladesh, China, India, Indonesia and Vietnam, and also in Cambodia, Pakistan, the Philippines, Sri Lanka and Thailand.

As FAO (2008) rightly notes, during the last quarter century, growth in food production has been high, lowering food prices. The recent increase in world agricultural prices happened against a historical background of prices that are quite low. The 17 major rice producers of Asia produced 120 kg per person in 1951; that rose to 166 kg per person by 1999, even though population had more than doubled. As a result, rice prices in world markets fell by about 80% in real terms between 1980 and 2000.

However, the real challenges lie ahead, since population in Asia will keep rising. The *OECD-FAO Agricultural Outlook 2007-2016* suggest that food prices may increase faster than the rate of inflation for the following reasons. First, rate of increase of grain yields has slowed to a trickle; and rice yield growth is slower now than population growth. Second, growth in adoption of modern rice varieties has slowed as adoption rates have reached plateaus of 75 to 90% in many countries; at the same time, expansion of area planted is impossible since alternative uses of land (roads, houses, other crops, industry) is growing. Third, the slower yield growth problem is intensified by growing incomes which means meat and poultry demand also grows; but it takes many kilograms of grain to produce one kilogram of meat.



Rising food prices in the future can have political consequences. For example, in the recent past, sharp increases in the politically sensitive rice price have triggered much social unrest and threatened governments in Indonesia. For a democratically elected government elected on a poverty reduction platform rising food prices have another unwanted consequence. Given that the poor spend more than 70 per cent of their household budget on food, increases in food prices result in a significant increase in the numbers falling below the poverty line. Similarly, we saw above what happened in Cambodia with rising food prices. In Vietnam, high inflation driven by spiking food prices has been a source of deep discontent and worry for governments. According to government statistics, about 300 strikes took place in the first quarter of 2008, up from 103 strikes in the same quarter of 2007 (ILO, 2008). This happened in spite of the new labour rules that make workers liable to compensate employers if they walk off the job illegally. The strikes reflect the resentment of migrant labour who left their farms to find work in the industrial centres of Ho Chi Minh City and Hanoi, but found that their wages, despite having risen (minimum wages grew annually over 2001-2007 at a brisk 14% per annum, according to ILO 2008) were whittled away by rising food prices. In other words, throughout the region the political imperative for increasing investment in agriculture, especially food items, is growing.

Other papers for this conference have argued that stunting of children is very high, or perhaps higher than might be expected at current levels of income in the region. If governments were convinced by such arguments, this problem is unlikely to have survived this long. Stunting is, quite literally, an “invisible” problem since it has been around for generations, and the elite learn to live with it (assuming that they even recognize it to be a problem) as long as it is the poor who suffer from it. Governments are more troubled by political and civil disturbances that might result from food prices rising faster than even inflation. Hence, consistent with the above argument, we would recommend a strategy that relies to a much greater extent than before on agriculture as a means of addressing existing poverty and preventing the anticipated increase in food prices. This policy requires both a production as well as a distribution component (the latter we have already discussed earlier).

The share of agriculture in the structure of output has been inevitably declining in East Asia and South east Asia, as we saw above. Yet, the share of agriculture in total employment has declined much more slowly. Agricultural decline may drive an increase in rural poverty, and inevitably to the migration of rural poor to urban areas. Multilateral financial institutions (e.g. the World Bank) and bilateral donors are increasing allocations for agriculture, and international attention to the subject is increasing (e.g. witness the last World Bank *World Development Report* was devoted to agriculture) – and recognizing that agriculture can be an engine of poverty reduction.

In East and South east Asia, within agriculture there will need to be a special focus on poultry/piggery, fisheries and forestry. Industrial production of pigs and poultry, already growing due to shortage of land, will have to increase. Production of pigs and poultry nearly doubled in the 1990s in China, Thailand and Vietnam (FAO, 2006). By

2001 these three countries accounted for more than half the pigs and one-third of the chickens in the whole world. There is a scope clearly for other countries in the region to expand output (just as India is doing with poultry and both India and Pakistan are with milk production).

Capture fisheries as well as aquaculture fisheries are central to East Asia and South East Asia for their food security and employment. In most countries in the region catching or farming aquatic resources is a key element in the livelihoods of rural folk. Fisheries and aquaculture both have deep cultural connotations for the people of this region. All types and sizes of fish are utilized in a wide variety of ways and very little is discarded or wasted. Of the top ten producers of capture fish, four are from this region: China (1<sup>st</sup>), Indonesia (5<sup>th</sup>), Japan (6<sup>th</sup>) and Thailand (9<sup>th</sup>). For aquaculture, among the top ten aquaculture producer states by quantity in 2004 (including aquatic plants) were China, Vietnam, Thailand, and Indonesia. More policy attention to both kinds of fisheries can improve rural livelihoods, but also have major backward and forward linkages with manufacturing.

Forestry also offers potential for improving livelihoods. There was a net increase in forest area of about 633 000 ha annually during the period 2000-2005, in contrast to Asia-Pacific's net loss of forest cover during the 1990s (FAO, 2007). The improvement in recent years was the outcome of increases of more than 4 mn ha per year in China and also investments in other countries such as Vietnam (and India and Bhutan) in afforestation and forest rehabilitation. But other countries have seen a net loss in forest cover, especially in South east Asia, where it has declined more than 2.8 mn ha a year, or at the same rate as in the 1990s. The most seriously affected are Indonesia (almost 1.9 mn ha lost per year), followed by Myanmar, Cambodia, the Philippines, Malaysia and the Democratic People's Republic of Korea (FAO, 2008). The moist forests of South east Asia are being burned, leading to huge losses of timber and also problems of air pollution and lost revenues in trade and tourism. Clearly, investing in forestry has a huge potential for improved livelihoods here, which could supplement the potential income from other sub-sectors in agriculture.

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