

# Developing Asia: coping with the global crisis

Developing Asia is facing its most challenging year since the 1997–1998 financial crisis. The collapse of world trade brought about by the global economic crisis is having a profound effect on manufacturing in the region. The slowdown is creating challenges for rural households as non-agricultural employment disappears. Quick responses from the region's policy-makers ought to mitigate the impact of the crisis.

Since the end of World War II, the world's economies have become increasingly more interconnected. Goods, workers, and capital now regularly crisscross national boundaries as barriers have fallen. The development success stories in East Asia bear witness to the immense benefits that can be obtained from openness. Yet, these connections also create risks as national economic crises become increasingly difficult to quarantine. The current global economic crisis started from failures in the US market for subprime mortgages. The effects of subprime failures snowballed beyond the U.S. financial sector, into global financial markets, and eventually smothered global trade and production.

Developing Asian economies – Asian economies excluding Japan – have suffered along with the rest of the world. In the *Asian Development Outlook 2009*, the Asian Development Bank (ADB) notes that the region's rapid gross domestic product (GDP) growth, which peaked at 9.5 percent in 2007, moderated to 6.3 percent in 2008

and may slow further to 3.4 percent in 2009 because of the global crisis. Although the global crisis originated in the finance sector, developing Asian economies have been affected more through real sector forces: the trade in goods and services.

## ■ Channels of contagion to developing Asia

Developing Asia's rapid growth relies on robust global trade. Since the fourth quarter of 2008, the drop in developing Asia's export growth has been calamitous, averaging nearly 30 percent in East and Southeast Asia and approaching double digits in South Asia (Figure 1, page 22). This dramatic reversal reflects the collapse in world

trade volume in recent months linked to vanishing import demand from the industrial economies. While growth has slowed throughout the region, economies that rely most on trade – such as the newly-industrialised economies of Hong Kong, China; Republic of Korea; Singapore; and Taipei, China – have been hit the hardest. GDP in the most open economies in developing Asia is expected to contract in 2009, on the back of collapsing world trade.

Slowing growth will hinder the pace of poverty reduction in developing Asia. More than 60 million people who would have been lifted above the income poverty line of USD 1.25

*Developing Asian economies are heavily dependant on global trade.*

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Photo: dpa/picture-alliance

per day, had the region's high growth continued in 2009, will remain trapped in absolute poverty (Hasan, Cain, and Magsombol; 2009). Moreover, the ADB, the United Nations Development Programme (UNDP) and the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) (2008) estimates suggest that economic growth contributes significantly towards achieving the non-income Millennium Development Goals. In essence, developing Asia will be hampered in its efforts to eliminate all forms of poverty because of the global slowdown.

### ■ Crisis impacts on rural Asia

The economies in the region hardest hit by the crisis are relatively developed and have production structures com-

posed largely of industry and services. Even within less advanced economies, it is the export and manufacturing centres where signs of the crisis are most obvious. Labour-intensive or export-oriented factories – such as electronics and toys in the PRC and Southeast Asia, diamond polishing and knitwear units in India, and clothing and footwear factories in Bangladesh, Cambodia, Indonesia and Sri Lanka – have been hit hard as industrial country demand has evaporated. Yet the links between the manufacturing sector and rural labour markets should not be discounted.

Manufacturing's decline will deliver an immediate blow to rural employment. A direct impact would be felt in factories for products that were located in rural areas to take advantage of cheaper labour or financial incentives implemented to decon-

gest towns and cities. Moreover, the rise of relatively better paying manufacturing jobs has drawn excess labour from rural areas in recent years. Many workers will now return to the countryside while those who remain in the cities will face diminished job prospects. For example, the concentration of the People's Republic of China's (PRC) rural migrants in the informal private sector and in export-oriented firms has reduced their wages much more than formal sector wages. The loss of non-agricultural income could be devastating to vulnerable rural households.

Families that rely on remittances from overseas workers will not be spared either. The



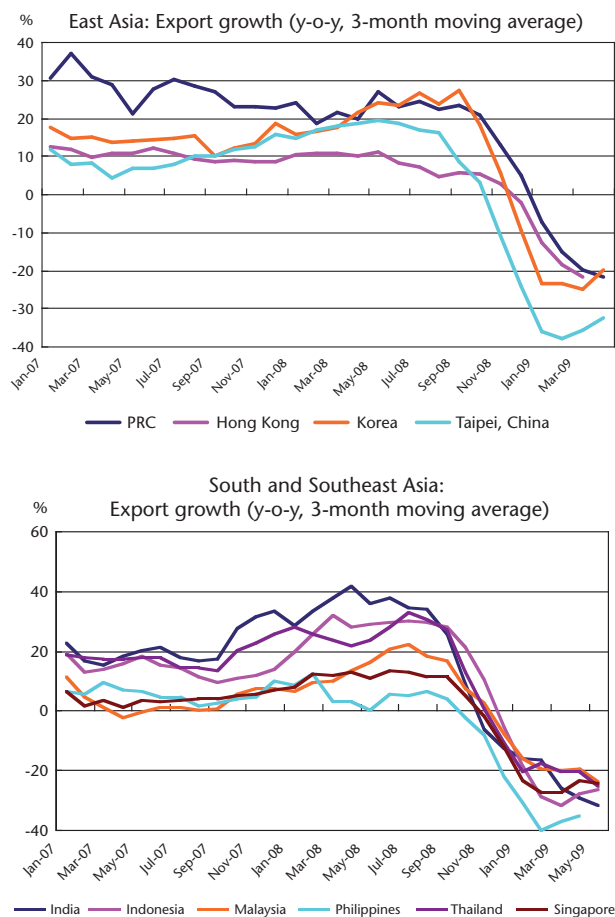
Photo: ADB/Richard Abrina

*In most Asian countries, stimulus packages lean toward investment in infrastructure but less on improving social safety nets such as unemployment benefits.*

slowdown in the major industrial economies – as well as the Middle East and the Russian Federation – is expected to temper the demand for foreign workers from developing Asia and reduce the flow of remittances. Since the onset of the crisis, the growth in remittance flows to Bangladesh and the Philippines has decelerated. In the economies of Central, South and Southeast Asia where remittances contribute substantially to national income, recipient families will suffer a significant blow to their household resources from falling remittances. The impact could be most pronounced in economies such as the Philippines, where remittances are about 10 percent of GDP and make up around 80 percent of receiving households' income.

The forces that fuelled the asset market bubbles in developed countries contributed to large swings in commodity prices in recent years (ADO 2008 Update). Commodities became the next asset class for speculators in

**Figure 1: Growth in exports from developing Asia**



Source: CEIC Data Company Ltd., downloaded 06 July 2009.

search of high returns, aggravating price volatility. Oil and non-oil commodity prices had been climbing steadily in recent years, only to plummet from their record levels as major industrial countries slipped into recession in 2008. Protectionist policies in food exporting countries (e.g. export controls in India, Thailand, and Viet Nam) may have deprived farmers from high world prices. Moreover, declining urban consumption and manufacturing export demand means diminished demand for agricultural products and raw materials. While prices still remain high compared to historical levels, the large swings in commodity prices reflect continued uncertainty about economic recovery.

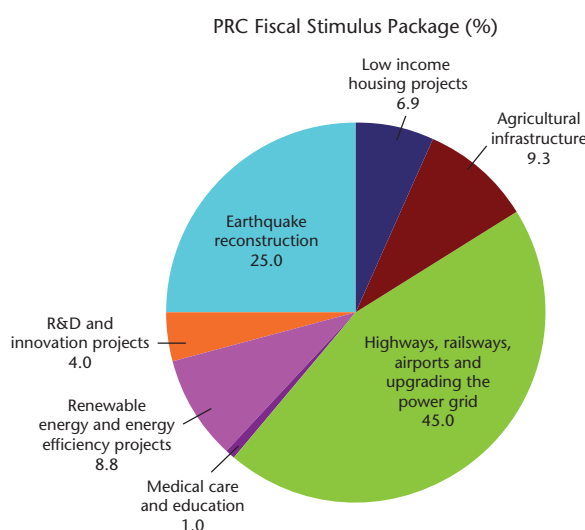
### ■ Developing Asia's response

As the economic slowdown took hold, authorities in many countries in the region eased monetary policy to ensure adequate liquidity in the face of the credit crunch. In particular, policy rates have been cut across the region. Falling energy and commodity prices allowed looser monetary policy to be pursued as inflationary pressures subsided. In a further effort to safeguard the reliability of banking systems, some monetary authorities set up or extended deposit guarantees. These efforts helped to shore up confidence in the financial system, but did little to counteract the effect of declining export demand on growth. As a result, authorities in the region began to turn to fiscal policy.

Higher public spending, tax cuts, and lower interest rates are expected to boost consumption and investment and offset the decline of private sector spending. In the major industrial

*Signs of the crisis are most obvious in labour-intensive or export-oriented factories, like clothing and electronics in China and India.*

**Figure 2: Fiscal Stimulus Package in the People's Republic of China (PRC)**



Source: Norton Rose Group. The PRC Fiscal Stimulus Package. Available: <http://www.nortonrose.com/knowledge/publications/2009/pub18883.aspx?lang=en-gb&page=all>

countries, so-called automatic stabilisers (such as progressive tax systems and unemployment benefits) are triggered in times of recession providing further fiscal stimulus to the economy. However, in developing Asia such stabilisers are sparse and social safety nets inadequate and inefficient. Stimulus packages announced by Asian countries generally lean toward investment in infrastructure, which would help long-term growth.

For example, authorities in the PRC announced a massive Renminbi (CNY)

four trillion fiscal package (equivalent to 13 % of GDP) composed mainly of infrastructure investments (see Figure 2). Fiscal support in the PRC also has a strong focus on improving the living standards of rural populations. Measures include expansion of stores and distribution centres in rural areas, investment in healthcare, extension of public pension schemes, subsidies on electronic appliances, lower interest rates and taxes to reduce the cost of housing, and issuing dividends by profitable state-owned enterprises. There are early

signs of the effect that the stimulus is having in the pick-up of construction activities, housing and retail sales, and higher bank lending. Firms have also begun to restock depleted inventories in anticipation of higher demand.

Since December 2008, the government of India has announced fiscal stimulus measures amounting to 1.5 percent of GDP. Authorities have allotted additional funds for critical rural infrastructure and social security programmes, authorised tax-free financing of public-private infrastruc-



Photo: ADB/Biggs Javellana



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*The Asian Development Bank reacted to the crisis by intensified investments in agriculture and rural development with special emphasis on the Greater Mekong sub-region, Bangladesh and Mongolia.*

ture projects, and launched a new pension scheme for all private-sector and self-employed workers. However, these measures, along with off-budget spending, have breached the targets under the government's fiscal policy rule and leave little room for additional spending in the full budget for 2009–2010. The rural components of the stimulus have focused largely on price and income supports, which combat only the cyclical factors rather

than providing the basis for sustained improvements in farm productivity and rural incomes.

Governments in the region face the harsh challenge of curtailing the impacts of the crisis while simultaneously pursuing their long-term development goals. Given generally weak automatic stabilisers and large output gaps in Asia, fiscal stimulus packages can play an essential role. Public invest-

ment projects such as rural infrastructure (rural roads, irrigation facilities, rural power), public transportation and low-cost housing, coupled with well-designed safety net programmes can create jobs, reduce poverty and promote growth. Ensuring that small- and medium-sized enterprises are not starved for credit would be another productive element of the stimulus packages. Instead of unsustainable subsidies, enhancing the poor's access to financial services can help them create assets and reduce poverty.

The Asian Development Bank has responded to the crisis by increasing its agriculture and rural development investments in developing Asia to USD two billion in 2009. Last year, it invested USD 1.2 billion to create new rural employment opportunities and support rural infrastructure, rural finance, food supply chains and agricultural technology. Specific support was approved for the Greater Mekong Subregion, Bangladesh, Mongolia, Pakistan and Sri Lanka.

### Zusammenfassung

Die Entwicklungsländer Asiens stehen vor dem schwierigsten Jahr seit der Finanzkrise 1997–1998. Der Zusammenbruch des Welthandels durch die globale Wirtschaftskrise hat tief greifende Folgen für die Fertigungsindustrien in der Region. Ländliche Haushalte sind von diesem Rückgang besonders stark betroffen, weil Arbeitsplätze außerhalb der Landwirtschaft wegfallen. Die Folgen der Krise müssen durch schnelles Handeln der politischen Entscheidungsträger der Region gemildert werden.

Steuerliche Anreize können hier eine wesentliche Rolle spielen. Öffentliche Investitionsvorhaben, zum Beispiel zur Förderung der ländlichen Infrastruktur (Straßen, Bewässerungsanlagen, Energie), öffentlicher Verkehrsmittel und erschwinglichen Wohn-

raums in Verbindung mit durchdachten sozialen Sicherungsprogrammen können Arbeitsplätze schaffen, Armut mindern und das Wachstum fördern.

Die Asiatische Entwicklungsbank ADB hat angesichts der Krise 2009 ihre Investitionen in die Entwicklung des Agrarsektors und der ländlichen Gebiete der asiatischen Entwicklungsländer auf zwei Milliarden US-Dollar angestockt.

### Resumen

Los países asiáticos en desarrollo afrontan el año más desafiante desde la crisis financiera de 1997–1998. El colapso del comercio mundial resultante de la crisis económica global viene teniendo un profundo efecto sobre la industria manufacturera de la región. Esta ralentización crea retos para los hogares rurales, a medida

que desaparece el empleo no agrícola. Las rápidas respuestas de las instancias políticas de decisión de la región deberían mitigar el impacto de la crisis.

Los paquetes de estímulos fiscales pueden jugar un rol esencial. Para reducir la pobreza y promover el crecimiento, resultan aconsejables los proyectos de inversiones públicas – tales como los de infraestructura rural (red vial rural, obras de irrigación, electrificación rural), transporte público y vivienda de bajo costo – aunados a programas sociales de protección cuidadosamente diseñados.

El Banco Asiático de Desarrollo ha respondido a la crisis incrementando sus inversiones en el desarrollo agrícola y rural de los países asiáticos en desarrollo, las cuales alcanzan dos mil millones de dólares en 2009.