



ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

Sixty-third session
17-23 May 2007
Almaty, Kazakhstan

**POLICY ISSUES FOR THE ESCAP REGION: IMPLICATIONS OF RECENT
ECONOMIC AND SOCIAL DEVELOPMENTS**

(Item 3 (a) of the provisional agenda)

**REPORT ON THE CURRENT ECONOMIC SITUATION IN THE REGION
AND RELATED POLICY ISSUES**

Note by the secretariat

SUMMARY

According to the *Economic and Social Survey of Asia and the Pacific 2007*, the Asia Pacific region grew strongly in 2006, with the developing countries growing 7.9 per cent and the developed countries 2.2 per cent. In keeping with the region's rapid integration with the global economy and the sectors in which it is most internationally competitive, the process of expansion was concentrated in the industrial and services sectors with agriculture growing at a lesser pace. Economic growth has been broad-based, with all subregions performing robustly. The countries of North and Central Asia as well as Australia, the Islamic Republic of Iran and a number of other countries witnessed strong growth in commodity exports, while much of East Asia experienced strong demand for manufactured goods, such as electronics.

For developing economies in the Asia-Pacific region, the economic growth outlook in 2007 is one of continued dynamism. Economic growth is projected at 7.4 per cent in 2007, somewhat lower than in 2006. The external economic environment is expected to be less favourable, mainly due to the slowing economy of the United States of America. A moderate decline is expected in global electronics demand in 2007 that may affect the Asia-Pacific region's prospects. In the meantime, the easing of commodity prices, including that of oil, will be a mixed blessing for the ESCAP region.

The *Survey 2007* assesses the economic and social costs of gender discrimination in the Asian and Pacific region, in particular, the economic losses of gender discrimination in relation to low labour force participation and low level of educational achievements. It also assesses the progress made in gender equality in four areas (economic participation, education, health and empowerment) with a comparative analysis that also highlights best practices. The publication analyses the status of gender inequality and factors leading to current disparities, and proposes policy recommendations to minimize gender discrimination in the region.

The present report also provides an overview of the progress made in the integration of the countries with economies in transition in the ESCAP region into the regional and global economies. The report assesses macroeconomic trends and analyses the role of ESCAP in integrating the countries concerned into the regional economy through international trade, information and communication technology and implementation of special programmes. The Commission is requested to provide further guidance on the issues discussed in the present document.

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I. IMPLICATIONS OF RECENT ECONOMIC AND SOCIAL DEVELOPMENTS

1. The *Economic and Social Survey of Asia and the Pacific 2007* analyses trends in the regional economy against the background of global developments and outlines the main policy issues facing the region. The *Survey* also considers the cost of gender discrimination in Asia and the Pacific and examines the actions that Governments can take to deal with the problem.
2. For the eighth consecutive year, the developing Asia-Pacific economies grew faster than all other regions in the world, with an impressive growth rate of 7.9 per cent in 2006, up from 7.6 per cent in the previous year (see table). With Asian and Pacific developing economies accounting for more than one third of global growth in 2006, the region is becoming the locomotive of global growth. In keeping with the region's rapid integration onto the global economy and the sectors in which it is most internationally competitive, the process of expansion was concentrated in the industrial and services sectors, with agriculture growing at a lesser pace.
3. The continued buoyancy of external demand remained an important source of growth for many countries in the region as the much-anticipated slowdown in United States growth failed to materialize in the manner that had been expected in 2006, and the continued revival of the Japanese economy provided an added stimulus. China and India featured as important drivers of external demand in the ESCAP region. China served as an export platform for the region, while its enormous demand for raw materials and fuels continued to keep global oil and commodity prices high, aiding the oil and commodity exporters throughout the region stretching from the Islamic Republic of Iran to Mongolia to Australia.
4. Economic growth has been broad-based, with all subregions performing robustly. As oil prices soared, so did the gross domestic product (GDP) of the oil- and gas-exporting countries in North and Central Asia, making it one of the world's fastest growing regions. Heading the pack was the world's fastest growing country, Azerbaijan, estimated to have grown at a blistering 34.5 per cent in 2006. The other major oil and gas exporters in the subregion also posted rapid expansions: Kazakhstan by an estimated 10.5 per cent, the Russian Federation by 6.7 per cent and Turkmenistan by 14 per cent. As the hydrocarbon sector grew, so did the demand for services and investment. In the Russian Federation, fixed capital expenditure grew by 11.7 per cent in the first nine months of 2006 (year on year). There was also more demand for services. Retail trade grew by 12.7 per cent in the first 10 months of 2006 in Azerbaijan, by 12.5 per cent in the Russian Federation, and by 23.4 per cent during the first half of 2006 in Turkmenistan. Growth was also strong elsewhere in the subregion.

Table. Selected economies of the ESCAP region: rates of economic growth and inflation, 2004-2007

	(Percentage)							
	Real GDP				Inflation a/			
	2004	2005	2006b/	2007c/	2004	2005	2006b/	2007c/
Developing economies of the ESCAP region d/	7.8	7.6	7.9	7.4	4.6	4.3	4.3	3.8
East and North-East Asia	8.4	8.1	8.5	7.8	3.3	2.0	1.6	2.1
China	10.1	10.4	10.7	9.9	3.9	1.8	1.5	2.0
Hong Kong, China	8.6	7.3	6.2	5.7	-0.4	0.9	2.0	2.3
Mongolia	10.6	6.2	7.5	6.0	11.0	9.5	5.1	..
Republic of Korea	4.7	4.0	5.2	4.8	3.6	2.7	2.5	2.5
Taiwan Province of China	6.1	4.0	4.2	4.1	1.6	2.3	0.6	1.7
North and Central Asia	7.5	7.1	7.5	7.1	10.0	11.8	9.4	8.8
Armenia	10.5	13.9	13.4	8.0	6.9	0.6	2.9	3.0
Azerbaijan	10.2	26.4	34.5	30.0	6.7	9.6	8.3	8.0
Georgia	5.9	9.3	7.0	5.0	5.7	8.2	9.2	7.0
Kazakhstan	9.6	9.5	10.5	10.0	6.9	7.6	8.6	7.5
Kyrgyzstan	7.0	-0.6	2.7	6.0	4.1	4.3	5.7	5.4
Russian Federation	7.2	6.4	6.7	6.4	10.9	12.7	9.7	9.0
Tajikistan	10.6	6.7	7.0	7.0	6.8	7.8	11.9	6.5
Turkmenistan	9.0	6.0	14.0	7.0	5.9	10.6	11.0	9.7
Uzbekistan	7.7	7.0	7.3	6.5	1.7	6.9	7.5	8.0
Pacific	3.8	2.7	3.8	3.7	3.4	2.4	2.8	2.7
Cook Islands	4.3	0.1	1.8	3.5	0.9	2.5	3.0	1.5
Fiji	5.3	0.7	3.6	2.0	3.3	2.7	3.5	4.0
Papua New Guinea	2.7	3.3	3.7	4.5	2.1	1.7	1.7	1.5
Samoa	3.7	5.1	3.5	4.7	16.3	1.9	3.2	4.0
Solomon Islands	8.0	5.0	6.2	5.0	6.7	7.2	8.2	8.4
Tonga	1.4	2.3	1.9	0.9	11.0	9.6	7.2	..
Vanuatu	5.5	6.8	7.0	7.0	1.6	0.9	2.3	2.4
South and South-West Asia e/	7.4	8.0	7.8	7.4	6.3	6.7	7.6	6.2
Bangladesh	6.3	6.0	6.7	6.0	5.8	6.5	7.2	7.0
India	7.5	9.0	9.2	9.0	3.8	4.4	6.0	5.0
Iran (Islamic Republic of)	4.8	5.4	6.1	6.0	15.2	12.1	11.0	9.1
Nepal	3.8	2.7	1.9	4.3	4.0	4.5	8.0	6.0
Pakistan	7.5	8.6	6.6	7.0	4.6	9.3	8.0	7.0
Sri Lanka	5.4	6.0	7.0	6.5	7.6	11.6	13.0	7.0
Turkey	8.9	7.4	6.0	5.0	8.6	8.2	9.5	7.1
South-East Asia	6.5	5.6	5.9	5.6	4.1	6.0	6.8	4.4
Cambodia	10.0	13.4	8.0	7.0	3.9	5.8	5.0	4.0
Indonesia	5.1	5.6	5.5	6.2	6.1	10.5	13.1	6.8
Lao People's Democratic Republic	6.9	7.2	7.5	7.6	10.5	7.2	7.0	7.0
Malaysia	7.1	5.3	5.6	5.7	1.4	3.0	3.6	3.2
Philippines	6.0	5.0	5.5	5.6	6.0	7.7	6.5	4.5
Singapore	8.7	6.4	7.6	4.7	1.7	0.4	1.0	1.5
Thailand	6.2	4.5	5.0	4.7	2.8	4.5	4.6	3.6
Viet Nam	7.8	8.4	8.2	8.3	7.8	8.3	7.5	6.8
Developed economies of the ESCAP region	2.8	2.0	2.2	2.0	0.2	0.0	0.5	0.9
Australia	3.6	2.7	2.5	3.0	2.3	2.7	3.5	2.5
Japan	2.7	1.9	2.2	1.9	0.0	-0.3	0.2	0.7
New Zealand	4.2	2.1	1.9	1.8	2.3	3.1	3.4	2.0

Sources: ESCAP, based on national sources; International Monetary Fund, International Financial Statistics CD-ROM (Washington, D.C., IMF, September 2006); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2006* (Manila, ADB, 2006); website of the Interstate Statistical Committee of the Commonwealth of Independent States, <www.cisstat.com>, 26 February 2007; and ESCAP estimates.

a/ Changes in the consumer price index.

b/ Estimate.

c/ Forecast/target.

d/ Based on data for 38 (developing) economies representing more than 95 per cent of the population of the region (including the Central Asian countries); GDP figures at market prices in United States dollars in 2004 (at 2000 prices) have been used as weights to calculate the regional and subregional growth rates. In the case of Pacific island economies for 2006, estimates are based on the figures available.

e/ The estimates and forecasts for countries relate to fiscal years defined as follows: fiscal year 2004/05 = 2004 for India, the Islamic Republic of Iran and Myanmar; and fiscal year 2003/04 = 2004 for Bangladesh, Nepal and Pakistan.

5. Growth jumped in East and North-East Asia from 8.1 per cent in 2005 to an estimated 8.5 per cent in 2006. Once again, China's strong expansion dominated the picture, with growth of 10.7 per cent. The services sector is particularly notable for its increase to 10.3 per cent. Services also showed good growth in the Republic of Korea (5.0 per cent), and Hong Kong, China (6.5 per cent). On the demand side, the share of gross domestic product (GDP) of China's exports increased to 37 per cent, although export growth decelerated from 28.4 per cent in 2005 to 27.2 per cent in 2006. The share of GDP of gross fixed investment increased to 43.6 per cent from 42.6 per cent. Reorientation of the economy towards consumer demand was yet to be seen as the share of GDP of private consumption decreased from 38 to 37 per cent.

6. With few exceptions, countries of the Pacific showed positive economic growth in 2006, ranging from slightly less than 2 per cent in Tonga to more than 6 per cent in Vanuatu. Growth was led by the primary sector in Papua New Guinea and the service sectors in the smaller countries. Most countries in the subregion maintained trade deficits as imports, pushed higher by rising oil prices, continued to outpace exports. In many countries, the trade deficit was financed largely by aid and remittances. Increased receipts from tourism and foreign direct investment are thus essential for them to maintain their balance of payments and foreign exchange reserves.

7. Strong economic growth continued in South and South-West Asia in 2006. India, the largest economy in the subregion, led the growth momentum by expanding 9.2 per cent. Afghanistan, Bangladesh, Pakistan and Sri Lanka posted growth rates of more than 6.5 per cent, with industry and services the major contributors. Exports increased in all of the countries, but imports grew even faster, partly due to higher oil prices, widening the current account deficits in Pakistan, Sri Lanka and Turkey. The Islamic Republic of Iran, the only net exporter of oil in the subregion, grew by 6.1 per cent and increased its current account surplus, the result of higher oil prices.

8. Driven by strong external demand, economic growth in South-East Asia was a robust 5.9 per cent in 2006, up from 5.6 per cent in 2005. As in previous years, strong external demand, especially for electronics (and to a less extent, commodities), was the primary source of growth. As a result, the current accounts of the major economies in the subregion are estimated to have remained in surplus, ranging from 25.9 per cent in Singapore to a modest 0.9 per cent in Viet Nam. As in the other subregions, higher oil prices were a source of inflationary pressure. Many countries allowed their exchange rates to appreciate rather than rely solely on interest rate hikes to cool their economies. Stronger currencies gave monetary authorities an opportunity to end the interest rate tightening that started in 2004.

9. All three developed countries in the region enjoyed modest growth in 2006. In Australia and New Zealand, capacity constraints tightened, creating inflationary pressure, while Japan was still looking for firm signs that it had graduated from deflation, with limited growth in wages despite signs of labour shortages. Higher labour incomes supported household consumption in Australia and New

Zealand, while sluggish labour incomes eroded it in Japan. With the robust economic growth of the past few years, the fiscal positions of Australia and New Zealand remained strong. In Japan, however, the large public debt accumulated during the decade-long recession of the 1990s still haunted the fiscal outlook.

10. Asian currencies performed strongly during 2006, reflecting larger-than-expected current account surpluses and capital flows, including those for speculative purposes. High interest rates in some countries, investors' appetite for risk, together with excess global liquidity attracted record levels of portfolio capital to the region. The major currencies appreciated significantly, notwithstanding the sudden portfolio capital outflows in mid-2006 that sent stock markets reeling across the region and currencies depreciating. With regard to widespread fears that currency appreciation was seriously eroding the competitiveness of exporting industries, the movements of real effective exchange rate, the most appropriate measure for gauging competitiveness, show that appreciation was on a lower scale in comparison with nominal appreciation vis-à-vis the United States dollar.

11. Developing countries in the ESCAP region have continued to add to their sizeable foreign exchange reserves, which reached an unprecedented level of US\$ 2.5 trillion at the end of 2006. Six countries and areas, China, the Republic of Korea, India, the Russian Federation, Hong Kong, China and Taiwan Province of China, accounted for over 82 per cent of total reserves. China, which eclipsed Japan to become the world's largest reserves holder, accounted for 40 per cent of the total reserves of the developing countries of the ESCAP region, or close to US\$ 1 trillion.

12. While the huge appetite for reserves in the Asia-Pacific region is partly a reaction to the Asian financial crisis, the large increase in reserves in 2006 points to continuing efforts to put some downward pressure on the region's currencies through official intervention. It is time to seriously consider the benefits and costs of holding excessive amounts of reserves. The prudent level of reserves that would safeguard a country against financial instability needs to be assessed against potential capital losses and quasi-fiscal costs.

13. Current account balances deteriorated across the region in 2006 mainly due to the rising oil imports bill though the impact was somewhat cushioned by the appreciation of currencies that made imports cheaper. Strong export performances in many countries offset some of the effects of rising oil prices. The region's exports grew at an impressive 18 per cent, similar to that of 2005, while imports growth picked up to 19 per cent from 17 per cent in 2005. As a result, economies in the region recorded larger-than-expected current account surpluses.

14. The region's exports benefited from healthy global demand, a rebound in the information technology sector and, for some countries, trade restrictions on China in the apparel sector. Although it showed signs of weakening, robust growth in the United States of America for 2006 has been a key

driver of the region's exports. This has been supported by improving demand in Europe and Japan. There was therefore an ideal situation of solid demand from all of the region's major traditional trading partners.

15. The revival of the Doha Development Round should be a priority for the countries of the Asia-Pacific region, which have benefited from freer trade in developing their economies. The failure to revive the Doha Round has been partly responsible for the proliferation of bilateral and regional trading agreements in the Asia-Pacific region. The 62 members and associate members of ESCAP are currently implementing 62 bilateral trade agreements (BTAs). Another 11 regional trade agreements (RTAs) with an average number of eight members are also in effect. Most of these agreements were signed after 2000 and thus represent a new trend for this region. The proliferation of BTAs/RTAs is now a fact of life, and it would be useful for policymakers across the region, particularly in smaller economies, to have a checklist to help minimize costs and maximize benefits to the economy. The checklist should encompass crucial issues at the conceptual, design, negotiation and implementation phases of an agreement (see the *Survey 2007* for more on this issue). Policymakers should aim as a rule of thumb to bring the preferential agreement as close to compliance with the World Trade Organization (WTO) as possible.

II. OUTLOOK FOR 2007

16. For developing Asia-Pacific economies, the economic growth outlook in 2007 is one of continued dynamism. Economic growth is projected at 7.4 per cent for 2007, lower than in 2006. The external economic environment is expected to be less favourable, mainly due to the slowing United States economy. Signs of slowdown in the United States have become clearer since the second half of 2006, as an easing of consumer demand and a cooling housing market are beginning to take a toll on the economy. GDP is expected to grow at 2.2 per cent, notably lower than the 3.2 per cent in 2006. In the European Union, a slight slowdown in activity is expected, with GDP declining to 2.4 per cent in 2007 from 2.7 per cent in 2006. As demand from the United States and the European Union is expected to decline, a moderate decline is expected in global electronics demand in 2007 that may affect the Asia-Pacific region's prospects. In the meantime, the easing of commodity prices, including that of oil, will be a mixed blessing for the ESCAP region.

17. As the international economic environment weakens, growth momentum in the Asia-Pacific region in 2007 is expected to come from strong growth in China and India, and the ongoing recovery of domestic demand in Japan. A rebound in economic growth in South-East Asian economies will add to the growth momentum. Together, these three economies contribute over 60 per cent of the GDP of the Asia-Pacific region and close to 45 per cent of imports, thereby creating considerable opportunities for the region.

18. The inflation in developing Asia-Pacific economies is projected at 3.8 per cent for 2007, falling from 2006 levels. Falling oil prices since mid-2006 are expected to lessen inflationary

pressures, while tight monetary policies across the region throughout 2006 are expected to reduce inflationary expectations in 2007. The exchange rates are expected to further appreciate in 2007 and it would also help to reduce inflationary pressure in the region. Even though the Governments of some countries, such as India, Indonesia and Malaysia, have removed oil subsidies and allowed retail oil prices to reflect international prices, inflationary pressures are expected to be subdued. For some East and North-East Asian economies, such as China and Hong Kong, China, and Taiwan Province of China, tightening labour and land markets will bring forth more challenges, although inflationary pressures are expected to be partly offset by tightening monetary policy and exchange rate appreciation.

19. Managing exchange rates will be the biggest macroeconomic policy challenge in the region in 2007. The nominal exchange rate in almost all countries of the region, especially South-East and East Asian countries, appreciated significantly against the United States dollar in 2006, despite interventions to keep currency values down. The appreciation is expected to continue in 2007 as the United States dollar would further depreciate in response to the country's large current account deficit, and capital would continue to flow into the region because of the favourable economic environment.

20. Following the experience of 2006, it would be increasingly difficult for monetary authorities to pursue an independent monetary policy in response to shocks, while targeting exchange rates in an environment of increasingly open capital accounts. Monetary authorities can choose a combination of any two of the following three policy options: monetary autonomy, exchange rate target and capital convertibility – but not all three. Ensuring that exchange rates are more flexible is the only sustainable solution. Greater flexibility should help take away the “one-way bet” that encourages even more capital inflows than would otherwise take place, since markets would quickly realize that the currency could move in either direction. The fear that a flexible exchange rate regime could become a source of volatility and have significant economic costs may be borne out to a large extent by the fact that, in many countries, foreign exchange markets are not well equipped to hedge against exchange rate fluctuations. Small and medium-sized exporters in particular are not able to make use of hedging instruments in managing risks. Attention needs to be paid to developing such instruments and further strengthening and deepening financial markets.

21. With the expected rebound in domestic demand, particularly for investment in South-East Asian economies and consumption in China, the current account surplus is expected to decline in Asian economies, though it will remain high. The further appreciation of exchange rates and a reduction in global demand for electronics and information technology components would also contribute to the decline in the current account surplus in the region. In particular, a moderate decline in the current account surplus is expected in China due to policy measures supporting consumption, reduction in oil subsidies, and greater exchange rate flexibility.

22. The 2007 forecast for the economic performance of the Asia-Pacific region is rather robust, but several downside risks remain. The possibility of a supply-side oil shock and a disorderly adjustment of global imbalances, among others, cannot be ignored. As such, the base line forecast would be increasingly tilted towards the downside risks. The potential for a supply-side oil shock could provide the impetus for further rises in international oil prices, thereby negatively impacting projected economic growth, inflation and the current account. As spare capacity remains low, even a moderate disruption in production capacity and/or a further escalation of security concerns in the Middle East, could raise oil prices above the baseline assumption. The widening of global imbalances is a concern. The current account deficit in the United States deteriorated by a further US\$ 100 billion in 2006. This deficit has been financed by economies registering current account surpluses. The surplus is, however, increasingly concentrated on a few countries – China, Germany, Japan and oil-exporting economies. A disorderly unwinding of global imbalances would lead to a sharp depreciation of the United States dollar together with a sudden increase in interest rates. A global recession with severe negative impacts on the Asia-Pacific region would be the result.

23. Within the region, there are some risks emerging from the two largest economies. Sustainable recovery of the Japanese economy depends on the ongoing process of fiscal consolidation to address ballooning domestic debt. Any disruption to fiscal consolidation could negatively affect consumer confidence and spending and, in turn, would threaten the Japanese recovery. As discussed above, the spectacular investment growth in China has raised worries about “overheating”. Given the increased importance of intraregional trade and investment linkages, a sharp slowdown in Japan and China could adversely affect other Asian economies.

III. POLICY ISSUES AND CHALLENGES

A. Oil prices

24. High and volatile oil prices were one of the central sources of difficulty in macroeconomic management in the region in 2006. High oil prices have created inflationary pressures, deteriorated current account balances and reduced foreign reserves in some countries. The price of oil rose to record levels in 2006, well over US\$ 70 per barrel in early August 2006 in response to the geopolitical situation in the Middle East. In real terms, prices surpassed their previous peak, reached during the 1979-1980 oil shock.

25. However, since August 2006, prices have been on a downward trend as tensions have decreased in the Middle East, a hurricane season in the Gulf of Mexico without major disruptions, and a warmer than usual winter season in Europe and North America. Nonetheless, further supply disruptions due to political instability in the Middle East and elsewhere cannot be ruled out. Adding to this pressure is the current unusually low level of spare production capacity of major oil producers. Prospects for a continued fall in oil prices to pre-2002 levels, just before the current ascent of oil prices, therefore remain uncertain.

26. Regional growth has so far been resilient to rising oil prices, aided by strong exports, high capital inflows and a benign global economic environment. However, a slowing United States economy and declining global demand for electronics may alter these conditions in 2007. Further hikes in world oil prices would adversely affect regional economic growth, inflation and current account balances. In oil-dependent Asia-Pacific economies, these impacts are much more pronounced than is the case for industrial countries. ESCAP simulations indicate that emerging Asia's growth would be reduced by 0.16 percentage point from a sustained 10 per cent increase in world oil prices. The Philippines, Singapore and Thailand would be the hardest hit as they have relatively high oil intensities. While consumer price inflation would increase for all emerging Asian economies, the effects would mostly be felt in India, Thailand, the Philippines and Malaysia. Current account balances would deteriorate in all emerging Asian countries, the effects being particularly substantial on Taiwan Province of China, Hong Kong, China and the Republic of Korea. In emerging Asia, current account balances as a percentage of GDP would deteriorate, on average, by 0.31 percentage point.

B. Low level of domestic demand

27. Over the past few years, the relatively low levels of domestic demand in East Asian economies has given rise to two types of interrelated concerns. First, the lack of domestic demand is argued to be one of the key sources of widening global imbalances. Second, declining domestic demand in these economies has meant that they have increased their reliance on exports to drive economic growth. Relying more on exports exposes these countries to risks of significant declines in external demand conditions, however, risks would be lower for a country relying more on domestic demand, such as India.

28. Investment was the key component that contributed to the declining share of total domestic demand in the crisis-affected East Asian countries, while consumption has remained fairly stable over the period, except in the Republic of Korea. Non-crisis-affected countries, with exception of China, also saw investment share in GDP decline. Except for Taiwan Province of China, the decline in investment is due to a significant drop in the private sector investment share in GDP, which has not yet recovered to its pre-crisis level. The share of public investment in GDP in these countries has been relatively constant. Private investment was badly hit in crisis-affected Indonesia, where the share in GDP fell by nearly half, followed by Thailand and Malaysia.

29. Further financial reforms are needed to promote private investment in East Asian economies. Although significant progress has been achieved in strengthening financial systems in East Asian economies,¹ more can be done, in the wake of the 1997 crisis, to ensure that prudential investors have

¹ After the crisis, weak financial institutions were segregated from strong ones and the latter adopted strict prudential measures in order to raise supervision to international standards. In addition, several measures to assist the recapitalization of banks and financial institutes have been granted. At present, the capital adequacy ratio in these countries is well above 8 per cent, which is the international standard requirement. The ratio of non-performing loans to total commercial bank loans is far lower than it was during the period of the crisis.

access to credit. Two sets of critical reforms are needed. First, the implementation of an improved risk management system should be prioritized so that banks no longer need to be excessively cautious when lending for investment activities. Second, to curb excessive growth of consumer credit, authorities in these countries should adopt prudential minimum payment and income requirements for credit cards. The creation of credit counselling and debt management services could help to reallocate the credit more efficiently. Furthermore, capital markets should be further developed as an alternative source of funds for investors. Finally, Governments should take further measures to create a favourable investment climate for private investment.

C. Economic vulnerability

30. In mid-2006, Asia-Pacific equity markets experienced their greatest drop since 2004. They continued falling throughout May and June, experiencing their greatest monthly decline since September 2002. After a brief respite at the end of June, equity markets were volatile again in July. All countries in the region were affected, suffering record falls for the year. The volatility reversed a sustained period of increases in financial asset values.

31. Markets have been volatile again in recent months, and more turbulence in the coming months cannot be ruled out. Further rises in developed country interest rates, in particular in the United States, the Euro zone and Japan, are possible if inflation shows signs of gaining momentum in these economies. Further oil price rises could trigger such a response. An abrupt unwinding of global imbalances leading to a strong depreciation of the United States dollar would also trigger significant interest rate hikes. The result may be a global economic slowdown, with Asian economies contracting due to a drop in demand for their exports. All these factors may reduce the appetite of investors for Asian financial assets. The effects of downside shocks may be amplified by investor overreaction and by contagion from portfolio outflows in other countries.

32. The present uncertainty in financial markets warrants careful monitoring of the economic vulnerability of countries in the region so that any danger signals can be recognized as early as possible. Relying on the economic growth indicator may be misleading because robust growth could mask the build-up of vulnerability in the economy and lull policymakers into inaction. Experience from the 1997 East Asian financial crisis shows that, in the lead-up to the crisis, good growth performance across crisis-affected countries concealed the build-up of economic vulnerability. This was in contrast to non-crisis affected countries, where there was robust economic growth and no significant sign of economic vulnerability.

33. To assess the overall state of a country's vulnerability to a currency crisis through a sudden reversal of capital flows, ESCAP has developed a composite vulnerability index covering nine emerging countries in the Asia-Pacific region for which data is available. They consist of five East Asian countries affected by the 1997 crisis – Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand – and four other emerging countries – China, India, Pakistan and the Russian

Federation. The composite index combines three aspects of vulnerability to a crisis, as measured in terms of inadequacy of foreign exchange reserves to short-term debts, excessive expansion in private domestic credit and real exchange rate appreciation. In the lead-up to the 1997 financial crisis, the index exhibited a persistent downward trend in all of the crisis-affected countries. The trend bottomed out in 1997, when the crisis began and spread. Such a downward trend, by contrast, was not observed in non-crisis-affected countries, such as China, India and Pakistan.

34. With the exception of Malaysia, crisis-affected East Asian countries are displaying renewed vulnerability in 2006. They were less vulnerable to the financial crisis during the period 2000 to 2004 than in the mid-1990s, as shown by an upward trend of the vulnerability composite index. However, the recent reversal of this trend in these countries merits a closer examination. Two factors are responsible: the appreciation of their real exchange rates as short-term capital inflows caused appreciation of the nominal exchange rate, and the pass-through of higher oil prices into non-traded goods, adding to inflationary pressures.

D. Structural challenges

35. Continued high rates of growth in the Asia-Pacific region would require not only that sound macroeconomic policies be maintained but also that steps be taken to address structural problems that may hinder sustained growth and development in the future. It may be easier to take serious policy and institutional measures when economic conditions are robust. There are three structural issues of importance in the region.

36. First, the high level of economic activity that has led to high levels of growth has also created a situation in which the region is bearing an increasingly greater share of regional and global environmental production-related burdens. There is evidence that, unless urgent steps are taken to “green” growth, the resulting environmental stresses would constrain the region’s growth potential.

37. Second, the rapid decline in fertility and the increase in life expectancy at birth in several countries in South-East Asia and in other developing countries of the region, is opening an historic, one-time only “demographic window” that provides an opportunity to spur economic growth. The remarkable growth of East Asian countries between the 1960s and the 1990s is partly due to the effective use of this “demographic dividend”.

38. Third, contrary to the conventional belief, there is evidence that urban poverty is much more pervasive in the Asia-Pacific region and is increasing at a rapid rate. In fact, urban poverty in many countries appears to be as bad as, if not worse than, rural poverty in terms of incidence and depth.

E. Green growth

39. The Asia and Pacific region’s contribution to global GDP has been steadily rising over the past decade. As a result of the region’s role as a global production centre, developing countries in the Asian and Pacific region are shouldering an increasingly greater share of regional and global

environment-related burdens. In fact, in more than half of the region's countries, current consumption pressures, as measured by the ecological footprint, exceed the available bioproductive area (productive natural resource endowment) per capita. The failure of national policy to address these growing environmental pressures will eventually take its toll on economic growth.

40. Conventional environmental management approaches have largely focused on improving environmental performance by controlling and regulating pollution and effluents from production processes. Environmental regulation remains a necessary part of green growth, particularly with regard to reducing pollution. However, a broader array of policies, economic instruments and management practices are required to make a fundamental change to consumption and production patterns.

41. In order to enable countries in the region to move towards green growth strategies, there is a need for eco-efficiency indicators that can assess a country's pattern of economic growth, monitor policy outcomes that promote eco-efficiency and allow comparisons of eco-efficiency measures between countries.

F. Reaping the “demographic dividend”

42. During the past half century, Asia has witnessed a considerable decline in total fertility rates: fertility rates have fallen from a high level of 6 children per woman in the period 1950-1955 to 2.4 by 2000-2005. Similarly, there was a remarkable decline in mortality rates in the period preceding the fertility decline, which was, during the initial stages, largely concentrated among younger persons. This particular sequencing of declines in fertility and mortality rates created a bulge in the age distribution, concentrated at the younger ages. Over time, the bulge has moved upward through the age structure to produce a large and rising working-age population with fewer dependent children and older persons to support. The growth in the labour force, along with increasing savings resulting from falling dependency ratios, will provide a tremendous boost to investment and growth in countries of the region. This window of opportunity only opens once in a lifetime and closes within a generation as the population ages and dependency increases.

G. Urban poverty

43. Over the past three decades, many urban centres in the Asia-Pacific region and their surrounding areas have functioned as engines of economic growth. At the same time, 571 million slum-dwellers in the region – more than half of the world's total – are experiencing the cumulated impact of an oversupply of labour, tenure insecurity, poor infrastructure, pollution and congestion. If this challenge goes unmet, economic growth will be offset by increasingly higher costs to keep urban centres functioning, which will place the Millennium Development Goals in many Asian countries a little further out of reach.

44. Slum areas, the physically and institutionally underdeveloped sites where most of the urban poor reside, create multiple challenges for their inhabitants. This finds its expression in the most common definition of slums, namely that they are characterized by one or more shelter deprivation factors as: lack of water, lack of sanitation, overcrowding, non-durable housing structures and insecurity of tenure. Jointly with significantly higher costs of living in urban areas, particularly for housing, the psychosocial pressure of the urban cash economy, the vulnerability of the urban poor to natural disasters and interpersonal violence, and significantly higher levels of pollution and related health hazards, slum life thus imposes specific burdens on those who bear it, which calls for specific policies to improve the situation of slum-dwellers.

IV. GENDER DISCRIMINATION

45. Gender inequality, as reflected in the restrictions placed on women's choices, opportunities and participation, is widespread in many parts of the world. It is often pervasive in Asia and the Pacific despite efforts at both the national and the global levels to reduce the gender gap. While some aspects of gender discrimination are a by-product of long-standing customs and cultural practices, the lack of a supportive institutional environment, including legal support for ensuring gender equality, can contribute to the perpetuation of discrimination. Gender discrimination is socially structured, and laws, policies and practices have a strong bearing, directly and indirectly, on discrimination against women.

46. Gender discrimination in the Asia-Pacific region is most visible in access to education and health services, economic opportunities and political participation. For example, the extent of gender inequality in certain countries of the region can be so wide that female primary school enrolment could be lower than that of males by as much as 26 per cent. Such disparities are also reflected in access to health services. The female-to-male ratio in the population is deteriorating, particularly in North and Central Asia, South Asia and the Pacific island economies, reflecting inadequate access to health services by women. In some countries, one in every ten infants dies before reaching their first birthday, and one in every 50 mothers dies during pregnancy and child delivery. This is despite the fact that, overall, health services and medical technology have improved over the years even in poorer countries. Meanwhile, violence against women continues, indicating how voiceless women are at both the household level and the national level.

47. Gender discrimination does not persist without cost. It has clear economic and social costs. Deprivation of access to education and health services by women and girls adversely affects labour force participation and human capital development, with a negative impact on economic growth and individual welfare. Women's lost opportunities also have an intergenerational impact as the health, education and well-being of children are adversely affected. Voicelessness and an inability to uphold their rights could deprive women of assets and obstruct economic and social participation. Violence against and abuse of women could have lifelong psychological costs that could negatively impact

women's self-esteem and capabilities, all having direct and indirect economic and social costs. The ESCAP estimates show that the region is losing US\$ 42-47 billion annually due to restrictions on women's access to employment alone. Similarly, gender inequality in education costs the region about US\$ 16-30 billion per year.

48. The elimination of gender imbalances would inevitably bring in tangible benefits not only to the individual but also to society at large. Eliminating gender discrimination and achieving gender equality require changes at the household, societal and national levels. In particular, mainstreaming gender concerns in public policies and programmes could make a difference in gender balance. Among the policy options which could help reduce gender discrimination and achieve equality among men and women are (a) improving the access of women and girls to social resources, such as education and health services; (b) enhancing the economic participation of women; (c) enhancing access to material resources; (d) empowering women; and (e) hearing the voice of women.

49. Lack of access to social resources, such as health services and education, by women and girls is one of the key factors leading to high levels of gender disparity in health and education, particularly in South Asian countries. This is due to both the restrictions imposed on them and a lack of institutions and resources. Both have to be addressed before gender discrimination can be eliminated.

50. Enhancing the economic participation of women is justified by both economic and social considerations. Direct and indirect restrictions placed upon women by employers, the work environment, public policies, cultural attitudes and the constant struggle to find a balance between work and family life force women to withdraw from the labour force. A change in policies towards the employment of women and in the mindset of individuals is necessary in order to stimulate female labour force participation.

51. Access to material resources, such as land, houses and credit, is essential not only so that women benefit from the freedom of choice but also so that their voice can be heard. As noted above, both traditions and laws restrict women's ownership of property, including land and houses. Traditional restrictions are influenced by the belief that the holding of assets by women is tantamount to a transfer of ownership and benefits to a third party after marriage. A change in the way that society differentiates between sons and daughters is essential in order to have an impact on gender bias regarding asset ownership.

52. The fact that gender discrimination starts in the family strengthens the case for making the family the centre of the effort to achieve gender balance. That effort could spill over to the society at large as gender balance progresses with time. Men can play a significant role in empowering women, making them equal partners and reducing gender discrimination at home, be it related to inheritance of family assets, access to health services and education, food distribution, violence or an equal voice in family decision-making. A change in societal expectations is necessary in order to change men's attitudes towards women and girls, in which civil society should play a lead role.

53. Improving the opportunities for women to make their voices heard is an effective way of reducing the gender imbalance. For this, a change in attitudes is required, and one effective way to accomplish this is through education. Educated fathers, husbands and brothers are more likely than uneducated ones to treat their daughters, wives and sisters equally. An educated woman is also in a better position to have equal representation than an uneducated woman, even at home. Cultural influences could also be addressed in a flexible manner through education. Civil society should take the lead in changing the mindset of men in that regard while government could provide support for them by eliminating gender-related restrictions on public- and private-sector employment and nomination for civil society organizations.

54. Removing gender-biased restrictions on women's participation in parliaments, public service, private sector employment and civil society should be the primary means of increasing women's representation at all levels. Positive gender discrimination, such as reserving a certain percentage of seats in local government bodies and national parliaments, may warrant consideration when other policies prove ineffective. However, the objective of giving women the freedom of choice should not be lost by imposing conditions. Women in different societies and cultures may have different aspirations, and that diversity needs to be respected.

55. There is a need to draw the urgent attention of policymakers to the issue of gender discrimination because perpetuating it would entail enormous socio-economic costs that the entire citizenry in a country would have to bear. It is the responsibility of all stakeholders, including civil society, the private sector and academia, to place this issue at the centre of the development agenda.

V. INTEGRATION OF ECONOMIES IN TRANSITION INTO THE REGIONAL AND GLOBAL ECONOMIES AND THE ROLE OF ESCAP

A. Macroeconomic trends

56. A favourable international environment, including robust world economic growth, buoyant trade, high commodity prices and low-cost international financing, has supported the strong economic performance of the countries with economies in transition in the Asian and Pacific region in 2005 and 2006, thus reinforcing their integration into the global and regional economy. These countries experienced their eighth successive year of GDP growth in 2006, the longest sustained expansion since the beginning of their transition to a market-based system in the 1990s. Positive GDP growth was recorded virtually across the region. From 2000 to 2005, annual average GDP growth ranged from 5 per cent or more in Mongolia, Cambodia, the Lao People's Democratic Republic, the Russian Federation and Viet Nam to more than 10 per cent in Armenia and Azerbaijan. The growth performance of the countries with economies in transition remained strong in 2006. Armenia grew by 13.4 per cent, owing mainly to a construction boom. Georgia and Uzbekistan continued their strong economic performance, growing by an estimated 7.0 per cent in 2006. The GDP of Tajikistan is expected to have increased by 7.0 per cent. Kyrgyzstan is expected to expand by 2.7 per cent owing

to an improved situation in agriculture, construction and trade – reversing the decline of 2005. Mongolia and Viet Nam also posted rapid expansions in 2006: Mongolia by an estimated 7.5 per cent and Viet Nam by 8.2 per cent.

B. Integration through trade

57. During 2005 and 2006, the Lao People's Democratic Republic, Viet Nam and several Central Asian economies continued their preparation for the process of accession to WTO. Viet Nam became the twenty-eighth member of ESCAP with full membership in WTO, increasing that organization's membership to 150, and resulting in 98 per cent of world trade being covered by WTO rules. ESCAP has worked with governments, businesses, researchers and civil society in all of these countries with a view to strengthening their ability (a) to formulate their trade policy reforms in such a way as to include the interests of the whole society, (b) to build and strengthen their negotiating capacity through a better understanding of the global trading system and the economic and social implications of adopting such reforms, and (c) to strengthen subsequent implementation of such reforms.

58. Economies in transition are parties to more than 20 BTAs/RTAs, some of which date from the early or mid-1990s but only few of which have helped achieve a significant increase in mutual trade or the level of integration of the parties concerned. This illustrates the fact that ensuring market access through trade agreements, even by accession to WTO, is often not sufficient on its own to drive the expansion of trade and, with it, national economic growth. While the opening of markets remains high on the policy agenda, it must be combined with the building of supply capacity for trade to proceed efficiently and competitively.

59. Improving trade facilitation by introducing and adopting simple, transparent and efficient international trade procedures in the region is a precondition for trading more and making trade more beneficial. In this connection, simplified, harmonized and standardized trade procedures and related documentary requirements are being promoted with the aim of reducing the costs and duration of international trade transactions across the region. ESCAP has worked tirelessly with governments on several fronts, including institutional capacity-building, application of the ESCAP Trade Facilitation Framework and time/cost-distance model, and formulation of national trade and transport facilitation reform action plans, including information and communication technology (ICT) applications.

60. The development of small and medium-sized enterprises (SMEs) remains critical for economic and social growth in economies in transition, where many SMEs are still in a nascent stage. Fostering SMEs is linked, among other things, to the development of financial markets, a business culture and the ability to attract foreign investors who are willing to co-invest with local companies. None of these things is easy in economies that are often predominantly resource- or agriculture-based. For enhanced competitiveness, these economies need to raise the capacity of SMEs to compete in regional and global markets. Therefore, ESCAP has been working on promoting subnational innovation systems and facilitating the formation of supply chains. Furthermore, ESCAP organizes

the annual Asia-Pacific Business Forum to facilitate connectiveness between major actors in development, government and business, and to foster corporate social responsibility.

C. Integration through ICT

61. ICT was recognized at the highest political level during the World Summit on the Information Society as a powerful tool for sustainable development, including the attainment of the Millennium Development Goals. For the countries with economies in transition, ICT has also created an opportunity for better integration into the regional and global development processes. Therefore, all of these countries have initiated actions to implement the outcomes of the Summit with the aim of ushering in the information society. All have developed national ICT strategies or have begun developing them. They have also improved ICT infrastructure, resulting in better ICT penetration, especially with regard to mobile telephones and ICT applications used by governments, businesses and the public. However, the level of ICT access remains comparatively low, with wide digital divides existing within countries and among different social groups. National ICT strategies are often not supported by an ICT policy and regulatory framework. The lack of human and financial resources is apparently the greatest challenge that most countries face in ICT development. In this regard, the activities of the secretariat aimed at providing those countries with assistance are focused on building capacity in ICT policymaking and ICT applications, which includes promoting ICT access points for the benefit of disadvantaged communities and providing ICT tools, such as the guidelines on ICT applications in trade and transport facilitation and the formulation of national action plans. The recently established Asian and Pacific Training Centre for Information and Communication Technology for Development is also expected to assist in capacity-building, particularly human resources development.

D. Implementation of the Special Programme for the Economies of Central Asia

62. Since 1998, the United Nations Special Programme for the Economies of Central Asia (SPECA) has had the objective of assisting its member countries² in strengthening cooperation in order to stimulate their economic development and facilitate their integration into Asia and Europe. SPECA is jointly supported and implemented by ESCAP and the Economic Commission for Europe. Priority areas of cooperation are transport, water/energy, trade, statistics, ICT and gender. The 2005-2006 SPECA work programme gained significant momentum. Currently there are 14 projects with funding assured (including funding under the fourth tranche of the United Nations Development Account): transport (5); water and energy (4); trade (2); statistics (1); and ICT (2); with a total outlay of about US\$ 4 million. In addition, three projects, in the fields of trade, statistics and ICT, with an outlay of about US\$ 1 million have been approved for funding under the fifth tranche of the United Nations Development Account. SPECA also has annual economic forums to engage with the private sector. In 2006, the Forum was held in Baku and dealt with energy issues. The 2007 SPECA

² Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

Economic Forum will comprise two meetings, to be held in Almaty and Berlin, and will focus on promoting Asian and European investment opportunities in Central Asia, particularly in the non-oil sector.

63. The Commission is invited to provide the secretariat with further guidance on the issues covered in the present document.

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