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REGIONAL COOPERATION IN THE ECONOMIC, SOCIAL AND RELATED FIELDS

Summary of the survey of economic and social conditions in Asia and the Pacific, 1995

SUMMARY

The developing economies of the Economic and Social Commission for Asia and the Pacific region have become increasingly integrated into the global economy through trade, factor and technology flows. Yet they have been able to withstand the adverse impact of the recession that hit the world economy in the early 1990s. Thus, in 1993 they averaged a growth rate of 7.2 per cent compared with that of 1.2 per cent for the world economy. Their growth performance improved further in 1994 to 7.7 per cent, while the trend towards narrowing the differential between subgroups of countries became more pronounced.

Prospects for 1995 and 1996 look bright, with projected growth rates of 7.5 and 7.0 per cent respectively. A number of factors support these optimistic projections, including the maintenance or acceleration of policy reforms that place a strong emphasis on deregulation, liberalization and outward-orientation; the growing strength of domestic markets, interregional trade and investment links; and the adoption of restructuring measures to enhance the competitiveness of exports.

Some recent external developments should also benefit the region, such as the conclusion of the Uruguay Round of multilateral trade negotiations and the

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coming into force of the World Trade Organization (WTO), and a revival of the world economy (estimated to grow at 3 per cent in 1995 and 3.4 per cent in 1996), which should boost exports from the region. However, there are some concerns. Higher domestic demand for capital in the industrial countries in the wake of the strengthened recovery, as well as the recent rise of interest rates in some major financial markets, may increase the cost of raising capital on the international markets or reduce its availability. The trend towards deceleration of official development assistance (ODA) flows will hurt many countries that depend on ODA because of their structural constraints in access to private capital.

One of the domestic policy areas that has undergone extensive reforms in recent years has been the financial sector. The survey of economic and social conditions in Asia and the Pacific, 1995 analyses these reforms and their impact. Most reforms relate to the reduction of barriers to entry for banks and other financial institutions; the deregulation of interest rates; the reduction in or elimination of directed credit programmes; the promotion of new financial markets and instruments; prudential regulations; and external financial liberalization. These reforms, while promising greater efficiency in financial services, also pose new policy challenges, particularly in relation to the maintenance of macroeconomic stability in the face of volatile international capital flows.

Despite the fast pace of economic growth, the region remains beset with many social concerns. The survey undertakes a review of the provisions for social security sponsored by legislation together with some other forms of public and private provision. The review indicates the lack of coverage for a vast segment of the poor and vulnerable.

In the light of the more detailed analysis contained in the present document and in the survey, the Council may wish to recommend follow-up studies on (a) economic restructuring following the conclusion of the Uruguay Round; (b) measures to maintain domestic macroeconomic stability in the face of volatile international capital flows; and (c) options to expand the coverage of social security systems with a view to exploring opportunities for regional cooperation.

CONTENTS

I. WORLD ECONOMIC DEVELOPMENTS AND THE ESCAP REGION

1. The developing economies of the region of the Economic and Social Commission for Asia and the Pacific (ESCAP) are becoming increasingly linked to the global economy through trade, investment, credit, technology and manpower flows. With a share of about 10 per cent of world gross domestic product (GDP), they account for about 15 per cent of world trade. Their share in world tourism income is of a similar magnitude and they are estimated to be receiving about a third of the world-wide remittances from people living outside their countries of citizenship. The earnings from tourism and remittances, running into billions of dollars, provide significant support to balance of payments and the growth of domestic income. The developing countries of the region, as a group, have emerged as the largest recipient of private capital and credit inflows to all developing countries in recent years (receiving, for example, 57 per cent of all foreign-direct-investment inflows to developing countries in 1992). With investment and credit also comes a sizeable inflow of technological inputs.

2. The degree of integration of the region with the world economy, as indicated above, is likely to intensify. Following recent liberal economic reforms and market-opening measures, most countries of the region are moving towards greater participation in the international division of labour. The implementation of the agreements reached under the Uruguay Round of multilateral trade negotiations and the establishment of the World Trade Organization (WTO) are expected to add further stimulus to this process. A greater integration also inevitably implies greater susceptibility to global developments in such areas as the growth of output and demand, trade, interest rates and capital flows.

3. The world economy has been going through a difficult period since 1990. Severe recession struck most of the industrialized countries, coinciding with an output decline in the former centrally planned economies. As a result, the rate of world output growth bottomed out at a mere 0.4 per cent in 1991, recovering only gradually with 0.7 per cent growth in 1992, 1.2 per cent in 1993 and 2.2 per cent in 1994. A more optimistic 3 per cent growth is forecast for 1995.

4. A characteristic feature of the recent recession, as well as the recovery, has been the differences in timing at which the various industrialized countries went through these phases. By 1994, however, with the exception of Japan (which experienced only a mild recovery), other industrialized countries had recovered strongly.

5. While the recession in the industrialized countries coincided with severe output decline in the countries with economies in transition to a free market system, the developing countries continued to grow. In particular, the economies of the ESCAP region grew at a higher average rate than both the world as a whole and the developing countries as a group. In 1993, for example, the average rate of growth of the developing countries in the ESCAP region exceeded 7 per cent, while the growth of world output was 1.2 per cent and that of developing countries as a group was 5 per cent. By 1994, some of the economies in transition in Eastern Europe had started to reverse the earlier trend of output decline. Although the economies of the Russian Federation and most other

members of the Commonwealth of Independent States (CIS) were still experiencing output decline, a broader-based recovery in the industrial economies, a softening of the output contraction in the countries with economies in transition and a continued good performance by the developing countries underpinned the higher growth of the world economy in 1994 and created better prospects for 1995.

6. Growth in world trade also suffered during the recession of the early 1990s. The rate of growth in world trade volume averaged 5.1 per cent during 1990-1993, after averaging 6.4 per cent during 1986-1990. A significant factor in the pattern of world trade growth was a dip in the rates of growth in imports in the developed market economies. These rates averaged 1.3 per cent in 1993, when in many countries there was a severe contraction of imports. (The European Union, for example, experienced a 4 per cent decline in imports.) Among the other adverse conditions of the world trading situation from the developing countries' point of view have been a continuous decline in the prices of primary commodities from 1990 to 1993 and a deterioration in their terms of trade.

7. In 1994, these adverse factors for world trade seemed to have been overcome, as indicated by estimates of more than 7 per cent growth in world trade, a similar percentage growth in industrialized countries' imports, and an almost 14 per cent rise in the index of non-fuel commodity prices. The conclusion of the Uruguay Round of multilateral trade negotiations and the establishment of WTO gave a further boost to confidence and improved the prospects for world trade and economic development, from which the developing countries of the region should also be able to benefit.

8. The world financial situation remained generally favourable for the developing countries. Interest rates fell to their lowest levels in recent decades, which helped to ease debt burdens and finance new borrowings. There was also an acceleration of private capital inflows to the developing countries, particularly in the form of bond lendings and foreign direct investment. However, in 1993, there was a sharp decline of $10 billion in official development assistance (ODA) flows over the 1992 level, which was of serious concern to the least developed and other disadvantaged groups of developing countries.

9. In 1994, with the recovery in the industrialized countries gaining strength and the threat of inflation re-emerging, monetary policy was being tightened, competition for the available capital resources was intensifying and interest rates were rising. Thus, the conditions under which the developing countries had had relatively easy access to capital sources in the international market were changing. The large budget deficits in many industrialized countries continued to be a factor in this scenario of competing demand for scarce capital resources and rising interest rates.

10. The coming into force of WTO on 1 January 1995, the most important event of the decade in international economic relations, is expected to have a far-reaching impact on trade, investment and economic growth in the ESCAP region. The major outcomes of the Uruguay Round, such as the liberalization of agricultural trade and the inclusion of textiles and garments in the ambit of the General Agreement on Tariffs and Trade (GATT), along with across-the-board

liberalization of trade in manufactures, promise not only to open up markets to exports from developing countries through the systematic removal of tariff and non-tariff barriers but also to expose them to greater competition. Similarly, the General Agreement on Trade in Services (GATS), while facilitating expanded inflows of foreign capital, will place increasing pressure on developing economies to liberalize and open up their service industries to foreign competition. In addition, they will face a number of constraints on some policy instruments frequently used in the past to promote the development of particular industries or sectors. Limitations on the use of trade-related investment measures can be cited in this context.

11. The developing countries in the region, therefore, will need to adjust their domestic economic policies to conform to international norms. This requirement may also call for a change in the patterns of specialization among countries. The exact impact will of course differ among countries, since the agreements under the Uruguay Round provide for the phased implementation of many provisions on the basis of product or service categories and the level of development of countries. It is therefore of utmost importance for each developing country to undertake a systematic examination of the impact of emerging policy obligations on the structure of its production and specialization in international trade.

II. MACROECONOMIC PERFORMANCE AND POLICIES

12. The developing economies of the ESCAP region have been relatively unaffected by the recession in the industrialized countries and many parts of the region have continued to register strong economic growth. Apart from the moderating effect of the unsynchronized pattern of the recession in the major industrial countries, the region’s ability to withstand the adverse impact of the recession can be attributed to the growing strength of domestic markets, intraregional trade and investment links, and the competitiveness of exports from the region, which are now well diversified into a variety of manufactures.

13. The developing countries of the ESCAP region further improved their average growth performance in 1994. Their combined growth rate was estimated at 7.7 per cent, compared with 7.2 per cent recorded in 1993, and but for a 1.6 per cent drop in China’s growth rate from 13.4 per cent in 1993, that rate would have increased much more. As in previous years, the average growth performance of the developing countries of the region in 1994 far exceeded an estimated 2.2 per cent rate of world economic growth. That differential is expected to continue, though with a narrower margin, since world economic growth rates are forecast to accelerate to 3.0 per cent in 1995 and 3.4 per cent in 1996, while those of the ESCAP region are expected to moderate to 7.5 and 7.0 per cent respectively.

14. Several factors support the projected high rates of growth for the region in the next two years. The momentum of policy reforms that place a strong emphasis on deregulation, liberalization and outward orientation will be maintained or accelerated throughout the region, providing a congenial environment for a sustained increase in domestic saving and investment. The higher production capacity thus created will be effectively complemented by

strong growth in domestic demand for higher quality goods and services from an expanding number of economically well-off consumers. Intraregional trade and investment are likely to maintain their upward trend in response to emerging changes in comparative advantage, duly supported by an intensification of regional cooperation, articulated through various regional and subregional cooperation arrangements. The conclusion of the Uruguay Round will create new opportunities for export expansion. With continued policy reforms and rising domestic demand, the region will continue to attract a significant share of global foreign investment inflows. However, rising domestic inflationary pressures, environmental concerns, infrastructural bottlenecks and some slackening in exports owing to slower growth in the North American economies could still have a moderating influence on the region's growth performance (see table 1).

15. The impressive growth performance of the developing countries of the region in 1994 was achieved with an estimated inflation rate of 9.9 per cent, compared with 7.3 per cent in 1993. Macroeconomic stability has been widely acclaimed as an achievement for the development policies of the ESCAP region. It is, therefore, somewhat disconcerting that the past year has seen a significant increase in the average inflation rate. Although the principal explanation for that increase lies in the dramatic upsurge of inflation in China from 13 per cent in 1993 to 21 per cent in 1994, a number of other countries have also experienced a substantial increase in inflation, with double-digit rates being recorded in India, Pakistan, Sri Lanka and Viet Nam. If China were excluded, the average inflation rate of the developing countries in the region - 6.3 per cent in 1994 - would still be 1 percentage point higher than it was in 1993.

16. As in the past, rates of economic growth continued to diverge in 1994 among the diverse groups of economies in the region (see table 2). However, a more pronounced tendency relative to the recent past for the growth rates of various economies to converge has been noticeable in 1994. Thus, while the average growth rate of both East and South-East Asian economies in 1994 increased only marginally, that of the South Asian economies and of the least developed countries registered an improvement by nearly a full percentage point.

17. A major acceleration of growth in the Lao People's Democratic Republic and Nepal, together with rather mild improvements in Bangladesh and Myanmar, brought about the improvement in the average growth rate of the least developed countries in 1994. These countries have embarked upon policy and institutional reforms in recent years to accelerate the mobilization of domestic resources, diversify exports and bring about other structural changes. Their prospects for sustaining the momentum noticeable in 1994 will depend a great deal on the successful implementation of those reforms and continued international support.

Table 1. Selected economies of the ESCAP region: forecasts of growth rates of gross domestic product (GDP) and inflation, a/ 1995-1996 b/

(Percentage)

	Real GDP		Inflation	
	1995	1996	1995	1996
Developing economies of the ESCAP region c/	7.5	7.0	8.3	6.3
Bangladesh	5.5	5.8	5.1	5.3
China	10.5	8.9	15.0	8.0
Fiji	2.7	...	1.0	...
Hong Kong	5.4	5.3	7.1	6.9
India	5.8	6.0	9.0	8.0
Indonesia	6.7	6.7	6.4	5.3
Malaysia	8.5	8.0	4.4	4.5
Nepal	4.5	...	7.0	...
Pakistan	6.8	6.4	8.0	7.0
Philippines	5.1	4.0	12.0	10.0
Republic of Korea	7.5	7.0	6.7	5.9
Singapore	8.3	7.8	3.0	3.0
Sri Lanka	5.8	6.0	11.3	9.1
Thailand	8.5	8.6	5.1	4.5
Viet Nam	9.5	10.0	10.0	11.0
Developed economies of the ESCAP region	2.5	2.9	0.8	1.3
Australia	4.0	3.0	2.5	3.5
Japan	2.4	2.9	0.7	1.1
New Zealand	4.0	3.2	2.1	1.8

Sources: ESCAP estimates; United Nations, Project LINK World Outlook (29 November 1994); and national sources.

a/ Refers to changes in the consumer price index, except for Fiji, for which change in GDP deflator has been used.

b/ Forecasts for countries relate to fiscal years, as follows: FY 1993/94 = 1993 for India; FY 1992/93 = 1993 for Bangladesh, Pakistan and Nepal.

c/ Based on data for 21 developing economies (including Taiwan Province of China) representing more than 95 per cent of the population of the region; GDP at market prices in United States dollars in 1990 have been used as weights to calculate regional growth rates.

Table 2. Economies of the ESCAP region: growth and inflation, 1991-1994

(Percentage)

		Gross domestic product	Inflation rate a/			Gross domestic product	Inflation rate a/
Least developed countries				Pacific Island countries			
Bangladesh	1991	3.4	7.2	Cook Islands	1991	7.0	4.6
	1992	4.2	4.3		1992	11.0	4.1
	1993	4.5	1.9		1993	1.2	...
	1994	5.0	...				
				Fiji	1991	0.7	6.5
Bhutan	1991	5.4	11.8		1992	2.9	4.9
	1992	4.5	16.0		1993	2.0	5.2
	1993	5.0	7.8		1994	3.2	...
Cambodia	1991	7.6	171.5	Papua New Guinea	1991	9.5	6.9
	1992	7.0	94.7		1992	8.5	4.4
	1993	5.7	120.2		1993	14.4	5.0
Kiribati	1991	0.5	5.6	Tonga	1991	5.4	13.3
	1992	4.0	4.0		1992	3.5	8.5
	1993	2.9	7.0		1993	2.8	3.2
Lao People's	1991	4.0	13.4	Central Asian republics c/			
Democratic	1992	7.0	9.8				
Republic	1993	4.0	7.0	Armenia	1991	-11.4	175.0
					1992	-46.0	1 500.0
Maldives	1991	7.6	14.7		1993	-9.9	1 500.0
	1992	6.3	16.8				
	1993	6.2	20.1	Azerbaijan	1991	-0.4	87.3
	1994	5.9	...		1992	-28.1	1 350.0
					1993	-13.3	2 000.0
Myanmar b/	1991	-1.0	32.3				
	1992	9.3	21.9	Kazakhstan	1991	-10.3	90.9
	1993	6.0	30.3		1992	-14.2	1 513.2
	1994	6.4	...		1993	-12.8	2 265.0
Nepal	1991	4.6	9.8	Kyrgyzstan	1991	-5.2	88.0
	1992	2.1	21.0		1992	-19.0	906.0
	1993	2.9	8.9		1993	-17.4	1 300.0
	1994	7.8	9.1				
				Tajikistan	1991	-8.4	85.0
Samoa	1991	-1.6	-1.4		1992	-31.0	913.0
	1992	-4.2	8.5		1993	-21.0	2 000.0
	1993	4.8	1.4				
				Turkmenistan	1991	-4.7	88.0
Solomon Islands	1991	3.2	15.1		1992	-5.3	831.0
	1992	8.2	10.7		1993	7.8	1 500.0
	1993	6.0	5.9				
				Uzbekistan	1991	-2.4	106.0
Tuvalu	1991	11.4	7.9		1992	-12.9	598.0
	1992	8.9	2.2		1993	-3.5	2 600.0
	1993	8.7	1.5				
Vanuatu	1991	3.5	6.5				
	1992	-0.1	4.2				
	1993	2.0	2.5				

		Gross domestic product	Inflation rate a/
South Asia			
India	1991	1.2	13.5
	1992	4.0	9.6
	1993	3.8	7.5
	1994	5.4	10.0
Iran, Islamic Republic of	1991	10.9	20.7
	1992	5.5	24.4
	1993	5.0	22.9
	1994	4.9	...
Pakistan	1991	5.6	12.7
	1992	7.7	9.6
	1993	2.3	9.3
	1994	4.0	11.2
Sri Lanka	1991	4.8	12.2
	1992	4.4	11.4
	1993	6.9	11.7
	1994	5.9	10.0
South-East Asia			
Brunei Darussalam	1991	3.6	1.6
	1992	-1.0	1.3
	1993	-4.0	4.3
Indonesia	1991	6.9	9.2
	1992	6.4	7.5
	1993	6.5	9.7
	1994	6.6	9.2
Malaysia	1991	8.7	4.4
	1992	7.8	4.7
	1993	8.5	3.6
	1994	8.4	4.0
Philippines	1991	-0.4	18.7
	1992	0.6	8.9
	1993	2.0	7.6
	1994	4.5	9.0
Singapore	1991	6.7	3.4
	1992	6.0	2.3
	1993	9.9	2.4
	1994	9.8	4.0
Thailand	1991	8.1	5.7
	1992	7.6	4.2
	1993	8.1	3.5
	1994	8.3	5.0
South-East Asia (continued)			
Viet Nam	1991	6.0	67.0
	1992	8.6	17.5
	1993	8.1	5.2
	1994	8.8	12.0
East Asia			
China	1991	8.2	3.0
	1992	13.0	5.4
	1993	13.4	13.0
	1994	11.8	21.0
Hong Kong	1991	4.1	12.0
	1992	5.3	9.3
	1993	5.6	8.5
	1994	5.4	8.3
Mongolia	1991	-9.9	120.1
	1992	-7.6	321.1
	1993	-1.3	200.0
	1994	2.5	...
Republic of Korea	1991	9.1	9.3
	1992	5.1	6.2
	1993	5.5	4.8
	1994	8.6	5.6
Developed countries			
Australia	1991	-1.3	3.2
	1992	2.5	1.0
	1993	3.5	1.8
	1994	4.7	2.0
Japan	1991	4.1	3.3
	1992	1.3	1.7
	1993	0.0	1.2
	1994	1.3	0.8
New Zealand	1991	-2.1	2.6
	1992	-0.2	1.0
	1993	4.1	1.4
	1994	3.8	1.5

(Sources and footnotes on following page)

(Sources and footnotes to table 2)

Sources: ESCAP, based on International Monetary Fund, International Financial Statistics, vol. XLVII, Nos. 10 and 12 (October and December 1994); Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 1994 (Oxford University Press, 1994) and Asian Development Outlook 1994 (Oxford University Press, 1994); Economic Commission for Europe, Economic Survey of Europe in 1993-1994 (United Nations publication, Sales No. E.94.II.E.1); The Economist Intelligence Unit, Georgia, Armenia, Azerbaijan, Kazakhstan, Central Asian Republics, fourth quarter 1994 (London, Business International Limited, 1994); United Nations, Project LINK World Outlook, various issues; International Monetary Fund, World Economic Outlook, October 1994; World Bank, World Tables 1994 (Johns Hopkins University Press, 1994); Organisation for Economic Cooperation and Development, OECD Economic Outlook, No. 56 (December 1994); The Economist Intelligence Unit, Country Report: Australia, 3rd and 4th quarters 1994 and Country Report: New Zealand, third and fourth quarters, 1994; and national sources.

Note: Data for 1994 are estimates.

a/ Refers to changes in the consumer price index.

b/ GDP at 1985/86 producers' prices.

c/ Gross domestic product or net material product.

18. In 1993, the average growth rate of the Pacific island economies was pushed up to 10.5 per cent, thanks to the unusually high growth rate of 14.4 per cent in Papua New Guinea, the largest economy in that subregion. The 1994 figures are not yet available for many countries, but the average rate of growth must have been lower since the growth rate of Papua New Guinea dropped significantly. In 1994, the prospects of these countries brightened, however, with a recovery of the prices of primary commodities, on which they were still heavily dependent for their foreign exchange earnings. Export prices of commodities, as well as continued access to the external resources that largely finance development programmes, will remain the major determining factors for their further prospects.

19. The Central Asian republics were still struggling to arrest hyper-inflation and the fall in output. Despite the traumatic experiences of a drastic reduction in per capita real income, it is significant that these countries have persevered in their pursuit of wide-ranging reforms. Some of these countries saw a moderation in output decline in 1994 and were expected to achieve positive growth by the end of 1995.

20. As indicated above, countries in the South Asian subregion (India, the Islamic Republic of Iran, Pakistan and Sri Lanka), excluding the least developed countries, experienced about a full percentage point increase in their average growth rate in 1994. This was largely due to accelerated growth in India and Pakistan. A further acceleration of growth in these two countries during the next two years can be expected, unless there are unforeseen set-backs.

21. South-East Asian economies (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam) registered an average growth rate of 7.5 per cent in 1994, compared with 7.2 per cent in 1993. The most significant development in this subgroup of countries was the pronounced recovery in the Philippines. Current projections indicate that most of these countries will maintain or even improve 1994 growth rates during the next two years.

22. In East Asia, the economies of China, Hong Kong and the Republic of Korea were estimated to have grown by an average of 9.8 per cent in 1994 compared with 9.7 per cent in 1993. In this subgroup, a major resurgence of growth occurred in the Republic of Korea, while China recorded a drop of 1.6 per cent in its growth rate, due to a variety of policy measures implemented since 1993 to arrest inflation. The prospects for the next two years for these economies remain bright. Hong Kong is likely to maintain its present growth rate, while in the Republic of Korea there is likely to be a minor deceleration compared with the very high growth achieved in 1994. In China, it is also expected that a further strengthening of anti-inflationary measures will slow down the growth rate by 1 to 2 percentage points. An estimated 2.5 per cent growth in 1994 of the Mongolian economy, which, in common with many other economies in transition, has been experiencing severe output contraction since 1991, should be cited as a remarkable achievement.

III. INTERNATIONAL TRADE AND BALANCE OF PAYMENTS

23. Against the background of changes in the world trading environment ushered in by the coming into force of WTO and continuing moves towards the formation of various regional and subregional groupings, the developing countries of the region have been in the process of implementing a wide range of policy reforms to be able to adjust to the new and emerging competitive conditions. The reform of policies, institutions and instruments impacting on trade has been an important focus of these policies. The reduction of tariffs, the relaxation or removal of controls, regulations, or non-tariff barriers, and the liberalization of foreign exchange regimes and adjustments in currency exchange rates have been major elements in external trade reforms undertaken by countries in the region in recent years.

24. There were also important developments in 1994 with regard to the establishment of regional and subregional trading arrangements within Asia and the Pacific under the auspices of organizations such as Asia-Pacific Economic Cooperation (APEC), the Association of South-East Asian Nations (ASEAN) and the South Asian Association for Regional Cooperation (SAARC). By and large, the movements towards the establishment of regional and subregional trade arrangements are motivated by recognition of the increasing importance of intraregional trade. Efforts to liberalize trade among countries belonging to particular organizations could be complemented by simultaneous efforts to establish closer links among them so as to more fully enhance the potential for expanding intraregional trade and investment.

25. With the exception of the least developed countries, the Pacific island economies and the disadvantaged economies in transition, both the export and import trade of other developing economies of the region remained buoyant in 1993 and 1994. The prospects for 1995 look equally good or better, underpinned by the strengthening of economic recovery in the industrialized countries, the likelihood of a more transparent and rule-based trading system under the auspices of WTO, and expectations of robust growth in intraregional trade within the Asia and the Pacific region. Meanwhile, domestic reforms and liberalization are being implemented by most countries, including the least developed and island developing countries and the economies in transition, so that they may benefit from the opportunities opening up globally and regionally.

26. In the past year, the least developed countries further strengthened their policy reforms in the area of trade. In general, the least developed countries have tended to relax foreign exchange controls to permit the exchange rates for their national currencies to reflect market rates; to reduce import duties; and to replace rigid quota systems with more transparent tariff systems. The least developed countries also continued efforts to diversify their exports. Bangladesh, for example, has been able to bring about a major change in the composition of its exports with success in exports, exports of ready-made garments, frozen fish and shrimps.

27. Sustained economic recovery in the industrial countries and the associated revival of commodity prices is likely to boost the export earnings of many least developed and Pacific island economies at least in the short term. The opening of markets under the auspices of WTO may also bring longer-term benefits to

those economies, although at the same time the value of some of the special concessions they have received, such as under the Lomé convention, may also be eroded.

28. The direction of foreign trade of the Central Asian republics remains largely geared towards CIS countries, although trade with non-CIS countries is growing in importance. Despite the introduction of national currencies in the Central Asian republics, no effectively functioning payments mechanism, particularly for trade with CIS countries, is yet in place. This has resulted in the development of an essentially bilateral form of trade, which has sometimes taken the form of barter transactions. As a group, the Central Asian republics experienced a drop in export earnings of close to 14 per cent in 1993, while imports rose by just over 2 per cent. With the exception of Kyrgyzstan and Tajikistan, all other republics experienced a sharp fall in export receipts.

29. The South Asian countries have generally experienced an increase in trade and capital inflows, following external sector reforms. Country performances in 1994 have not been uniform. In most cases, there was a positive growth of exports as well as imports. The current account deficit is expected to decrease for most South Asian countries, often because of a reduction in imports. There have been some changes in the structure of exports. In general, dependence on traditional export items as major foreign-exchange earners has declined as a result of export diversification.

30. Despite considerable liberalization of exchange control regimes in the majority of South Asian countries, exchange rates have been fairly stable, thus bolstering the confidence of policy makers to pursue further reform in that direction. Liberalized investment policies and incentives have brought substantial amounts of non-debt-creating capital inflows in some countries.

31. The strong economic performance of all the economies in South-East Asia is directly linked to the impressive performance of their export sectors. In these economies, export growth in 1994 exceeded that of 1993. Manufactures dominated exports in all these economies, except in Viet Nam, where exports of primary commodities were still predominant. High rates of growth in exports were partly responsible for the high rates of growth in imports, which exceeded 10 per cent in 1994 in all the South-East Asian countries. In 1993 and 1994, Indonesia and Malaysia recorded surpluses on their merchandise trade accounts, while the rest of the South-East Asian economies incurred deficits. Singapore was the only country in this group that had a surplus on its goods, services and income transfers account. The Philippines, Thailand and Viet Nam faced substantial balance-of-payments deficits on goods, services and income, equivalent to roughly 6 per cent of GDP in 1993. Large inflows of capital have kept the overall balance of payments of all these countries in surplus in recent years.

32. Economic recovery in the developed countries and strong growth in intraregional trade provided a stimulus to growth in the East Asian economies. Economies of the subregion have benefited from the rapid diversification of their exports from labour-intensive consumer goods to capital- and skill-intensive electronic equipment and consumer durables that have enjoyed sustained global demand.

33. Exports to China from the countries of the East Asian subregion have been boosted by strong economic growth in China and its expanding economic linkages in Asia. Direct investment in China originating from other East Asian economies surged in 1994 and helped to generate an expansion in the exports of capital goods, manufactured inputs and consumer durables from those economies to China. As a part of its trade policy reforms, China has recently lowered tariff rates, eliminated many non-tariff barriers and allowed its currency to move towards convertibility. These measures led to a strong surge in imports, a growing share of which came from other East and South-East Asian economies.

IV. REFORM AND LIBERALIZATION OF THE FINANCIAL SECTOR

34. As a part of their wider economic reforms, most developing countries of the region have been implementing financial sector reforms for about a decade. Prior to reforms, the financial sector in most countries was highly controlled and regulated by the Government. In many countries, banks were set up in the public sector or private commercial banks were nationalized. Governments designed and directed credit programmes, controlled interest rates, limited the access of its citizens to foreign currencies, restricted the access of foreigners and maintained fixed exchange rates. The motivations behind these actions were several and varied with the stage of development of the economy. Since most countries adopted a planned development strategy, their financial policy was tailored to serve the needs of the priority sectors identified in development plans. Financial policy was also used to achieve distributional objectives, by extending subsidized credits to the weaker sections of the society and establishing financial institutions in the remote parts of the country. Large fiscal deficits in some countries also necessitated greater government control over the financial sector.

35. However, financial policy aimed at achieving these diverse objectives created numerous distortions and inefficiencies. In addition, the problem of bad debts and non-performing loans became serious, threatening the solvency of many financial institutions; hence the pressure for reforms and liberalization, which were reinforced by a number of other considerations. The change in the development paradigm to allow greater roles for the private sector and for market forces in economic management was one such reform. In addition, the substantial changes occurring in the external environment that affected both the real and financial sectors necessitated greater efficiency in the financial sector for countries to be able to compete successfully in the international market-place. Thus, as the economies of the region grew and became more diversified their financial needs changed and the need for reform of the financial sector was felt strongly. The removal of controls was considered essential for the development of new financial institutions, markets, instruments and services.

36. The various elements of reforms that have been introduced and implemented in the countries of the region can be grouped into several major areas: the reduction of barriers to entry for banks and other financial institutions; the deregulation of interest rates and the reduction in or elimination of directed credit programmes; the promotion of new financial markets; and external financial liberalization.

37. The structural reforms undertaken in the banking sector centred on privatizing State-owned banks, reducing barriers to entry for both domestic and foreign private banks, liberalizing the types of activities that banks could undertake and, concomitantly, improving the prudential regulation of financial institutions. These reforms were intended to increase competition in the financial sector in the provision of services to customers, improve the payments system and encourage savings through the banking system. Another major element of reform in most developing countries in the region has been the progressive deregulation of interest rates and the curtailing of directed credit programmes, with interest rates on concessional loans being brought closer to market interest rates. Most countries in the region have followed a policy of rather cautious gradualism in removing restrictions on interest rates.

38. These reforms are expected to have a positive impact on the volume or form of domestic savings. Although it is recognized that the mobilization of savings through the banking system is related not only to interest rates but also to a number of other variables, a positive real interest rate is considered to be an important policy tool. Available data tend to suggest that the real rate of interest for depositors, which was almost invariably negative in 1980, became positive, with very few exceptions, by the mid-1980s. Those rates have continued to be positive well into the 1990s, but adjustments in nominal rates have apparently not kept pace with inflation rates. Both gross domestic savings and financial savings as a percentage of GDP increased in most countries of the region between 1980 and 1993.

39. Financial liberalization is expected to enhance the operational efficiency of the banking sector through enhanced competition. One measure of operational efficiency is the spread (or the intermediation margin) between the deposit and the lending rates. The intermediation margin is affected by several factors, including the operating expenses of banks, legal reserve requirements, inflation rates and the relative importance of non-performing loans in an institution’s portfolio. The spread between the lending and deposit rates in a number of countries has tended to widen, at least for some initial years after liberalization. However, there is some evidence that intermediation margins have started to decrease in some countries.

40. Rapid economic growth as well as financial liberalization contributed to the rapid development of other financial institutions and markets. Institutions, such as leasing companies, insurance firms, securities companies, pension funds and mutual funds, are fast-growing segments of the financial system in most countries, although their share of the market has remained relatively small. There has also been a significant shift by enterprises from loan to equity or bond finance. As a result, stock markets in many Asian countries have demonstrated dynamism and their growth in terms of capitalization, turnover and returns has far outpaced the older established markets of the world. The establishment of a single agency responsible for the development and regulation of the capital market has been a significant step in many countries in putting their stock markets on a sound footing. Private debt securities markets are also growing, with corporate bond markets in the initial stages of development in many countries of the region. This has led to the establishment of independent credit rating agencies for corporate bonds in some countries.

41. External financial liberalization policies have included the decontrol of foreign-exchange transactions on the current account, making exchange rates flexible, and removing or easing restrictions on capital flows. Capital account liberalization has included allowing banks and businesses to borrow offshore in foreign currencies, opening domestic financial market institutions and instruments to foreign participation, and allowing domestic institutions to establish foreign branches or affiliates.

42. One favourable consequence of the relative openness of the financial sector has been an acceleration of foreign private capital inflows, with the developing countries of the ESCAP region becoming the largest recipient of private capital flows among all developing countries world wide. At the same time, these capital flows have made the management of the financial sector and monetary policy a challenging task.

43. The experiences of the countries that have undertaken financial reforms show that a stable macroeconomic environment is an essential precondition for such reforms to succeed, since reforms carried out against an unstable macroeconomic background can aggravate that instability. High and variable inflation rates can make interest rates, especially real interest rates, very high and unstable. This can discourage savers and lead to the insolvency of enterprises and financial institutions. In addition, deregulated interest rates in combination with a flexible exchange rate can result in extremely volatile capital flows.

44. Most of the fast-growing economies in Asia undertook both fiscal and real sector reforms before introducing financial sector reforms. Under structural adjustment programmes, some countries in the region, especially in South Asia, introduced trade, fiscal, financial and other reforms more or less simultaneously. The appropriate approach with respect to the sequencing of reforms is significantly dependent upon the political system, economic structure and administrative capacity of an individual country. However, there is a general presumption that the real sector should be reformed first so that it can transmit the appropriate price signals. When prices are distorted because of protection or price controls, financial reforms can have a limited impact on the efficient allocation of resources, one of its key objectives. Within the nexus of financial reforms, it appears that most reforms can be carried out together, except that domestic financial reforms should perhaps precede the relaxation of controls over international capital flows, because when domestic interest rates are controlled and low, capital account reforms can lead to a massive outflow of finance.

45. Since the process of reform in the financial sector in Asian countries is likely to continue, the focus of attention has switched to problems related to the consolidation of reforms and the consequences of such reforms. While no country in the world has totally deregulated its financial market, it is important to distinguish between government interventions that lead to inefficiency and misallocation of resources and those that are designed to support, supervise and exercise prudential control to correct market failures and maintain systemic stability. Governments can and must assume an important role in maintaining public confidence in financial institutions and instruments;

this cannot be achieved without adequate prudential regulations and their effective implementation by Governments.

46. One consequence of a more market-based system is an increased exposure to various forms of instability. First, financial institutions are increasingly exposed to the risk of insolvency. The new easier entry conditions for financial institutions in the liberalization process can lead to a proliferation of financial institutions, many of which may not have the requisite resources, experience or competence to operate on a sound actuarial basis or be able to carry out satisfactorily the functions of risk assessment for loans. They may accumulate unbalanced portfolios of assets and liabilities, including an unsustainable set of non-performing loans, and so may risk collapse.

47. Second, enterprises are faced with a wider range of opportunities for raising finance but more instability in its costs. Interest rates on loans, the value of stocks issued and the face value of bonds will be variable, beyond their control. This requires them to be more vigilant in their decisions on how much investment finance to raise and what markets to tap. It also increases the possibilities of their insolvency for reasons connected with public assessments of their profitability, which in turn increases their need for good accounting systems and the ability to produce sufficient information to convince investors to buy or hold their debt.

48. Third, capital markets themselves can be a source of instability. Stock markets are well known for booms and busts largely unrelated to market fundamentals. Such movements are often caused by speculative runs, insider trading and frauds. They lead to unexpected losses for market participants and create a crisis of confidence, leading to reduced trading. The success of any capital market is thus conditioned by the adequacy of its supervisory rules and monitoring system.

49. One of the challenges resulting from liberalization and deregulation in the financial sector is how to cope with increasing integration into the global financial system and the increasing interdependence of the system itself. For example, differentials in real interest rates between countries have become a deciding factor in determining the placement of short-term investments. Changes in such differentials between domestic and foreign markets can cause large movements of funds. With destabilizing effects on exchange rates, the domestic money supply and consequently on prices, thus making the conduct of monetary policy a difficult task. It appears that Governments can try to influence exchange rates or inflation/interest rates.

50. Several countries in the region have experienced volatility in short-term capital flows, caused by either domestic or external changes, that have obliged central banks to intervene in efforts to neutralize their destabilizing impacts. Such interventions have included bond issues and high reserve requirements on foreign liabilities, sometimes involving unexpected costs for central banks.

51. Thus, financial sector as well as trade sector reforms are forcing countries to learn how to function in a global system. Their freedom to make independent policy decisions is becoming constrained as both domestic and foreign concerns react quickly to the signals given. In addition, changing

circumstances or policies in the major economies of the world can create large reactions in small economies, irrespective of their own policies and economic fundamentals. The implications of this globalization for developing economies in the region are not yet fully understood and deserve further attention; there is a considerable scope for strengthening mechanisms for the exchange of information and experience in this area.

V. SOCIAL SECURITY IN THE ESCAP REGION

52. Poverty remains a fundamental problem in the region. Sustained economic growth and various types of policy interventions have considerably mitigated the incidence of poverty in many countries of the region. However, large segments of the population in many countries and very large absolute numbers of people remain poor, and the region still contains three quarters of the world’s poor people. Poverty manifests itself in many forms of deprivation that become permanent features in the life of the poor. Lack or inadequacy of food, health and education, housing and sanitation, as well as poor nutrition, are the principal forms of deprivation.

53. Poverty and deprivation are also generated or worsened by vulnerability to a series of causes, some of which are incidental to modern socio-economic processes. In some situations, the new emphasis on a greater reliance on market forces in economic management may aggravate deprivation. Social security has evolved as one of the ways to provide relief against such deprivation.

54. The concept of social security can be described in terms of both ends and means. As defined in International Labour Organization (ILO) conventions, social security can be taken to mean the protection that society provides for its members, through a series of public measures, against the economic and social distress that would otherwise be caused by the stoppage or substantial reduction in earnings resulting from old age, invalidity, death, sickness, employment injury, maternity and unemployment. Along with provisions for medical care and subsidies for families with children, legally defined benefits and compensations are to be paid to the people concerned. As a means of providing the intended benefits, at least four types of measures are used, with defined rules for contributions to be made and benefits to be derived by those participating.

55. Social insurance is a publicly sponsored and legally compulsory insurance system with contributions from employers and employees, which may be subsidized by Government. Legislation may extend voluntary coverage to those excluded from the compulsory schemes. The principle of social insurance is grounded in sharing risks and financial costs. This principle may also be used for the non-formal organization of social security. Contributions are accumulated in special funds, out of which benefits are paid according to a person’s record of contributions, usually without applying means-based tests. Benefits flow in the form of pensions or other compensations, depending on the nature of the contingencies covered. Social insurance can separately cover most of the above-mentioned contingencies, with benefit entitlements going to those who are insured against any of them. In principle, it can be comprehensive, covering all contingencies for a whole national population.

56. Social assistance is a system of social security, that is financed from general revenue rather than from individual contributions. Such assistance can cover a number of the above-mentioned contingencies, with benefits that are adjusted according to a person's means. It is often designed to bring a person's total income up to a certain minimum level. However, the State can choose - and many countries have chosen - to finance social security benefits, such as pensions to the aged, the invalid, the orphaned and the widowed, as well as free medical care, from general revenue.

57. A third social security mechanism, known as employer liability, was originally designed for protection from the risk of employment injury, placing legal responsibility on the employer to provide compensation and medical care in respect of employment injuries either directly or under approved insurance policies. Subsequently, the scope and extent of employer liability have been extended to cover such contingencies as sickness and maternity, including provisions for paid sick and maternity leave. Employers may also be obliged under labour laws to give workers the right to severance or redundancy payments on dismissal, as well as to provide medical care for the workers themselves and their family members.

58. Many countries, especially in the developing world, have established state provident funds as a means of compulsory saving, with contributions usually paid both by the employers and employees. A central fund is thus created, with the contributions credited to separate accounts for each individual. The credit thus accumulated, with interest added, is paid out to the individual in the event of old age, invalidity, or in case of death to the survivors.

59. Social security mechanisms, as indicated above, have grown along with the social services that are generally provided by the State. Such social services extend to a wide range of provisions, such as health services and preventive health care, accident prevention and rehabilitation, special facilities for the disabled and old people, and child welfare.

60. The provision of social services by the State derives its rationale from the recognition that social security in its conventional sense may be necessary but not sufficient to meet the needs of the developing countries, in which permanent deprivation and vulnerability are integral to the life of many. Social security in the developing countries, therefore, needs to be interpreted broadly. In the long run, it has to be mediated through both the growth process and the adoption of public policies and actions to facilitate a wide participation of the population in the process of economic expansion, particularly through the promotion of skills, education and employment.

61. The need for public provision of social security measures remains immense. Despite rapid economic growth, the region still contains a huge number of poor people. The incidence of certain vulnerabilities has increased with rapid industrialization and urbanization. The changing demographic profile is creating a situation in which a smaller number of adults have to support a larger number of dependants, particularly elderly dependants. Moreover, the role of the family, which has been the most important traditional source of support, may have weakened as a result of a number of social and economic

factors. Economic growth and improved living standards also tend to enhance expectations for social security systems.

62. The survey on existing provisions for social security sponsored by State legislation in the region, together with some other public and private support provisions, suggests that the vast majority of the region's poor and vulnerable population fall outside the formally legislated social security networks. Many of them fall outside other forms of public support systems as well. The financial, infrastructural and administrative limitations on bringing such people into a comprehensive system of social security or welfare are enormous in most countries of the region. The issue of expanding the coverage of an administratively feasible and financially viable social security system is likely to assume an increasing importance on the policy agenda.
